ITRON INC /WA/
Form 10-K
February 22, 2013

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

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 000-22418
ITRON, INC.
(Exact name of registrant as specified in its charter)

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, no par value	NASDAQ Global Select Market
Preferred share purchase rights	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No ý
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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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. ý
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	ý	Accelerated filer	¨
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of June 29, 2012 (the last business day of the registrant’s most recently completed second fiscal quarter), the aggregate market value of the shares of common stock held by non-affiliates of the registrant (based on the closing price for the common stock on the NASDAQ Global Select Market) was $1,616,930,208.

As of January 31, 2013 there were outstanding 39,301,339 shares of the registrant’s common stock, no par value, which is the only class of common stock of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

The information called for by Part III is incorporated by reference to the definitive Proxy Statement for the Annual Meeting of Shareholders of the Company to be held on May 3, 2013.

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

Certain Forward-Looking Statements

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

PART I

ITEM 1: BUSINESS

Available Information

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

General

Itron is a technology company and one of the leading global suppliers of a broad range of standard, advanced, and smart meters and meter communication systems, including networks and communication modules, software, and services. Our communications network platform supports robust and standards-based internet protocol, power-line-carrier, and cellular networks supporting multiple protocols according to our customers' needs around the world. Our software provides mobile and networked meter reading, customer care, billing, distribution design and analysis, forecasting, and load research. Our wide range of services include delivery solutions and managed services on-site or through private cloud solutions.

We were incorporated in 1977 with a focus on meter reading technology. In 2004, we entered the electricity meter manufacturing business with the acquisition of Schlumberger Electricity Metering. In 2007, we expanded our presence in global meter manufacturing and systems with the acquisition of Actaris Metering Systems SA (Actaris).

The following is a discussion of our major products, our markets, and our operating segments. Refer to Item 7: “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in this Annual Report on Form 10-K for specific segment results.

Our Business

We offer solutions that enable energy utilities to build smart grids to manage assets, secure revenue, lower operational costs, improve customer service, and enable demand response. Our solutions include standard meters and next-generation advanced and smart metering products, systems, and services, which ultimately empower and benefit consumers.

We supply comprehensive solutions to address the unique challenges facing the water industry, including increasing customer demand and resource scarcity. We offer a complete product portfolio for applications in the residential and commercial industrial markets for water and heat.

We classify metering systems into three categories: standard metering, advanced metering systems and technology, and smart metering systems and technology. These categories are described in more detail below:

1

Standard Metering

A standard meter measures electricity, natural gas, water, or thermal energy by mechanical, electromechanical, or electronic means, with no built-in remote-reading communication capability. Standard meters require manual reading, which is typically performed by a utility representative or meter reading service provider. Worldwide, we produce standard residential, commercial and industrial (C&I), and transmission and distribution (T&D) electricity, natural gas, water, and heat meters.

Advanced Metering Systems and Technology

Advanced metering uses a one-way communication module embedded in or attached to the meter to collect and store meter data, which is transmitted to handheld computers, mobile units, and/or fixed networks. This allows utilities to collect meter data for billing systems and analyze the data for more efficient resource management and operations. Worldwide, we produce electricity, natural gas, and water advanced metering systems and technology. Communication technologies can vary by region and country and include telephone, RF (radio frequency), cellular, PLC (power line carrier), and Ethernet devices.

Smart Metering Systems and Technology

Smart meters have two-way communication capability to automatically and regularly collect and transmit meter data to support various applications beyond monthly billings. Our smart metering solutions have substantially more features and functions than our advanced metering systems and technology. Smart meters are capable of collecting and storing interval data, remotely connecting and disconnecting, sending detailed information, receiving commands, and may interface with other devices, such as in-home displays, smart thermostats and appliances, home area networks, and advanced control systems.

Bookings and Backlog of Orders

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

Year Ended	Annual Bookings	Total Backlog	12-Month Backlog
	(in millions)		
December 31, 2012	$1,861	$1,035	$568
December 31, 2011	2,120	1,296	766
December 31, 2010	2,396	1,620	913

Information on bookings by our operating segments is as follows:

Year Ended	Total Bookings	Energy	Water
	(in millions)		
December 31, 2012	$1,861	$1,357	$504
December 31, 2011	2,120	1,610	510
December 31, 2010	2,396	1,866	530

Our Operating Segments

We operate under the Itron brand worldwide and manage and report under two operating segments, Energy and Water. The transition to the new organizational structure, including changes to operations, as well as financial and management systems, was completed in the first quarter of 2012. The segment discussions in Management's

Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and our consolidated financial statements have been revised to reflect our new operating segments. Refer to Item 7: "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8: "Financial Statements and Supplementary Data," both of which are included in this Annual Report on Form 10-K.

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

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Sales and Distribution

We use a combination of direct and indirect sales channels in both operating segments. A direct sales force is utilized for the largest electric, natural gas, and water utilities, with which we have long-established relationships. For smaller utilities, we typically use an indirect sales force that consists of distributors, sales representatives, partners, and meter manufacturer representatives.

No single customer represented more than 10% of total revenues for the years ended December 31, 2012 and 2011. One customer, Southern California Edison, in our Energy operating segment, represented 11% of total company revenues for the year ended December 31, 2010. Our 10 largest customers in each of the years ended December 31, 2012, 2011, and 2010, accounted for approximately 27%, 33%, and 34% of total revenues, respectively.

Raw Materials

Our products require a wide variety of components and materials, which are subject to price and supply fluctuations. We enter into standard purchase orders in the ordinary course of business, which can vary in terms and can include purchase orders for specific quantities based on market prices, as well as open-ended agreements that provide for estimated quantities over an extended shipment period, typically up to one year at an established unit cost. Although we have multiple sources of supply for most of our material requirements, certain components and raw materials are supplied by sole-source vendors, and our ability to perform certain contracts depends on the availability of these materials. Refer to Item 1A: “Risk Factors”, included in this Annual Report on Form 10-K, for further discussion related to supply risks.

Product Development

Our product development is focused on both improving existing technology and developing innovative new technology for electricity, natural gas, water, and heat meters, data collection software, communication technologies, data warehousing, and knowledge application solutions. We spent approximately $179 million, $161 million, and $139 million on product development in 2012, 2011, and 2010, which represented 8%, 7%, and 6% of total revenues, respectively.

Workforce

As of December 31, 2012, we had approximately 8,500 people in our workforce, including permanent and temporary employees and contractors. We have not experienced significant work stoppages and consider our employee relations to be good.

Competition

We provide a broad portfolio of products, systems, and services to electric, gas and water utility customers globally and, consequently, operate within a large and complex competitive landscape. Some of our competitors have diversified product portfolios and operate in multiple geographic markets, while others focus on specific regional markets and/or certain types of products, including some low-cost suppliers based in China and India that have significant market shares for standard meter sales in their respective home/regional markets. Some of our competitors are part of multinational conglomerates. Our primary competitors for each operating segment are discussed below. We believe that our competitive advantage is based on our in-depth knowledge of the utility industry, our capacity to innovate, our ability to address customer concerns by providing complete end-to-end integrated solutions (including metering, network communications, data collection systems, meter data management software, and other metering software applications), our established customer relationships, and our track record of delivering reliable, accurate, and long-lived products and services. Refer to Item 1A: “Risk Factors” included in this Annual Report on Form 10-K for a discussion of the competitive pressures we face.

Energy

We are among the leading global suppliers of electricity and gas metering products, including standard meters, communication and network technologies, and other advanced and smart metering systems and technologies.

Within the electricity business line, our primary global competitors include Landis+Gyr (Toshiba) and Elster (Melrose PLC). Other major competitors for electricity products include Sensus (The Resolute Fund, L.P.) in the North America market, GE Energy (General Electric Company) in the North America and Asia Pacific (APAC) markets, and

Echelon in the Europe, Middle East and Africa (EMEA) market. Each of these companies offer some form of advanced/smart meter technologies as well as standard meters. In addition, we compete with companies that specialize in communication and network technologies that are used with third-party standard meters, including Aclara (ESCO Technologies), Silver Spring Networks, and Trilliant.

Our primary global competitors for gas products include Elster, Sensus, and Landis+Gyr. For gas meter communication modules, we also compete with Aclara primarily in North America.

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Water

We are one of the leading global suppliers of standard and advanced water meters and communication modules. Our primary competitors include Elster, Sensus, Diehl Metering (Diehl Stifung & Co. KG), Neptune Technologies (Roper Industries), and Badger. Each of these companies offers some form of advanced meter technologies and operates in various major world markets, except for Badger and Neptune Technologies, which primarily operate in North America. For water meter communication modules, we also compete with Aclara.

Strategic Alliances

We pursue strategic alliances with other companies in areas where collaboration can produce product advancement and acceleration of entry into new markets. The objectives and goals of a strategic alliance can include one or more of the following: technology exchange, product development, joint sales and marketing, or access to new geographic markets. Refer to Item 1A: “Risk Factors” included in this Annual Report on Form 10-K for a discussion of risks associated with strategic alliances.

Intellectual Property

Our patents and patent applications cover a range of technologies, which relate to standard metering, advanced metering systems and technology, smart metering systems and technology, meter data management software, and knowledge application solutions. We also rely on a combination of copyrights and trade secrets to protect our products and technologies.

Disputes over the ownership, registration, and enforcement of intellectual property rights arise in the ordinary course of our business. While we believe patents and trademarks are important to our operations and in the aggregate constitute valuable assets, no single patent or trademark, or group of patents or trademarks, is critical to the success of our business. We license some of our technology to other companies, some of which are our competitors.

Environmental Regulations

In the ordinary course of our business we use metals, solvents, and similar materials that are stored on-site. We believe we are in compliance with environmental laws, rules, and regulations applicable to the operation of our business.

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MANAGEMENT

Set forth below are the names, ages, and titles of our executive officers as of February 21, 2013.

Name	Age	Position
Philip C. Mezey	53	President and Chief Executive Officer
Steven M. Helmbrecht	50	Sr. Vice President and Chief Financial Officer
John W. Holleran	58	Executive Vice President and Chief Operating Officer
Marcel Regnier	55	President and Chief Operating Officer, Water
Jared P. Serff	45	Vice President, Competitive Resources
Russell E. Vanos	56	Sr. Vice President, Strategy and Business Development
Shannon M. Votava	52	Vice President, General Counsel and Corporate Secretary

Philip C. Mezey is President and Chief Executive Officer, and a member of our Board of Directors. Mr. Mezey was appointed to his current position and to the Board of Directors effective January 1, 2013. Mr. Mezey joined Itron in March 2003 as Managing Director of Software Development for Itron’s Energy Management Solutions Group as part of Itron’s acquisition of Silicon Energy Corp. Mr. Mezey was promoted to Group Vice President and Manager of Software Solutions in 2004. In 2005, Mr. Mezey became Sr. Vice President, Software Solutions, and in 2007 Mr. Mezey became Sr. Vice President and Chief Operating Officer, Itron North America. Mostly recently, Mr. Mezey served as President and Chief Operating Officer, Energy from March 2011 through December 2012.

Steven M. Helmbrecht is Sr. Vice President and Chief Financial Officer. Mr. Helmbrecht joined Itron in 2002 as Vice President and General Manager, International, and was named Sr. Vice President and Chief Financial Officer in 2005. Previously, Mr. Helmbrecht was Chief Financial Officer of LineSoft Corporation, which was acquired by Itron in 2002.

John W. Holleran is Executive Vice President and Chief Operating Officer, effective January 1, 2013. Mr. Holleran joined Itron in January 2007 as Sr. Vice President, General Counsel, and Corporate Secretary. Beginning in January 2012, Mr. Holleran served as Itron's Sr. Vice President, Special Projects, and Corporate Secretary.

Marcel Regnier is President and Chief Operating Officer, Water. Mr. Regnier joined Itron in April 2007 as part of our acquisition of Actaris. Mr. Regnier served as Managing Director of Actaris' water and heat business unit from 2001, when Actaris was created as a result of the reorganization of Schlumberger’s operations, until April 2008, when he was promoted to Sr. Vice President and Chief Operating Officer, Itron International. In March 2011, Mr. Regnier was promoted to his current position.

Jared P. Serff is Vice President, Competitive Resources. Mr. Serff joined Itron in July 2004 upon our acquisition of Schlumberger’s electricity metering business. Mr. Serff spent six years with Schlumberger, the last four of which as Director of Human Resources with Schlumberger’s electricity metering business where he was in charge of personnel for all locations in Canada, Mexico, France, Taiwan, and the United States.

Russell E. Vanos is Sr. Vice President, Strategy and Business Development, effective January 1, 2013. Mr. Vanos joined Itron in 1980 and since then has held various positions in sales, marketing, and operations. Most recently Mr. Vanos served as Vice President, Global Smart Grid Solutions and Business Development from November 2011 through December 2012. Prior to this role Mr. Vanos served as Vice President and General Manager, Sales and Marketing from January 2011 to November 2011 and as Vice President, Marketing from January 2007 through December 2010.

Shannon M. Votava is Vice President, General Counsel and Corporate Secretary. Ms. Votava joined Itron in May 2010 as Assistant General Counsel and was promoted to Vice President and General Counsel on January 1, 2012, and she assumed the responsibilities of Corporate Secretary on January 1, 2013. Before joining Itron, Ms. Votava was Associate General Counsel, Commercial at Cooper Industries plc from October 2008 to April 2010 and General Counsel at Honeywell Electronic Materials, Inc. from 2003 to October 2008.

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ITEM 1A: RISK FACTORS

We are dependent on the utility industry, which has experienced volatility in capital spending.

We derive the majority of our revenues from sales of products and services to utilities. Purchases of our products may be deferred as a result of many factors, including economic downturns, slowdowns in new residential and commercial construction, customers' access to capital upon acceptable terms, the timing and availability of government subsidies or other incentives, utility specific financial circumstances, mergers and acquisitions, regulatory decisions, weather conditions, and fluctuating interest rates. We have experienced, and may in the future experience, variability in operating results on an annual and a quarterly basis as a result of these factors.

Utility industry sales cycles can be lengthy and unpredictable.

The utility industry is subject to substantial government regulation. Regulations have often influenced the frequency of meter replacements. Sales cycles for standalone meter products have typically been based on annual or bi-annual bid-based agreements. Utilities place purchase orders against these agreements as their inventories decline, which can create fluctuations in our sales volumes.

Sales cycles for advanced and smart metering systems are generally long and unpredictable due to several factors, including budgeting, purchasing, and regulatory approval processes that can take several years to complete. Our utility customers typically issue requests for quotes and proposals, establish evaluation processes, review different technical options with vendors, analyze performance and cost/benefit justifications, and perform a regulatory review, in addition to applying the normal budget approval process. Today, governments around the world are implementing new laws and regulations to promote increased energy efficiency, slow or reverse growth in the consumption of scarce resources, reduce carbon dioxide emissions, and protect the environment. Many of the legislative and regulatory initiatives encourage utilities to develop a smart grid infrastructure, and some of these initiatives provide for government subsidies, grants, or other incentives to utilities and other participants in their industry to promote transition to smart grid technologies.

Section 1252 of the U.S. Energy Policy Act of 2005 requires electric utilities to consider offering their customers time-based rates. The Act also directs these utilities and state utility commissions to study and evaluate methods for implementing demand response, to shift consumption away from peak hours, and to improve power generation.

The European Union has issued the EU Energy Package, which includes directives and regulations intended to strengthen consumer rights and protection in the EU energy market. The EU's 20-20-20 goals include a 20% increase in energy efficiency, a 20% reduction of carbon dioxide emissions compared with 1990 levels, and producing 20% of its energy from renewable sources by 2020. The package requires EU Member States to ensure the implementation of smart metering systems and outlines deployment by 2022, with 80% of electric consumers equipped with smart metering systems by 2020.

While we believe these initiatives will provide opportunities for sales of our products, the pace at which these markets will grow is unknown due to the timing of legislation, regulatory approvals related to the deployment of new technology, capital budgets of utilities, and purchasing decisions by our customers. If government regulations regarding the smart grid and smart metering are delayed, revised to permit lower or different investment levels in metering infrastructure, or terminated altogether, this could have a material adverse effect on our results of operation, cash flow, and financial condition.

A significant portion of our revenue is generated with a limited number of customers.

Historically, our revenues have been concentrated with a limited number of customers, which change over time. Our largest single customer represented 8% of total revenues for the year ended December 31, 2012. We are often a party to large, multi-year contracts that are subject to cancellation or rescheduling by our customers due to many factors, such as extreme, unexpected weather conditions that cause our customers to redeploy resources, convenience, regulatory issues, or acts of terrorism. Cancellation or postponement of one or more of these significant contracts could have a material adverse effect on our financial and operating results. In addition, if a large customer contract is not replaced upon its expiration with new business of similar magnitude, our financial and operating results would be adversely affected.

As we enter into agreements related to the deployment of smart metering systems and technology, the value of certain contracts can be substantially larger than contracts we have had with our customers in the past. These deployments last several years and can exceed the length of prior deployment agreements. The terms and conditions of these smart metering system agreements

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related to testing, contractual liabilities, warranties, performance, and indemnities can be substantially different than the terms and conditions associated with our previous contracts.

Our quarterly results may fluctuate substantially due to several additional factors.

We have experienced variability in quarterly results, including losses, and believe our quarterly results will continue to fluctuate as a result of many factors, including those risks and events included throughout this section. Additional factors that may cause the price of our common stock to decline include:

- a higher proportion of products sold with fewer features and functionality, resulting in lower revenues and gross margins;
- a shift in sales channel mix, which could impact the revenue received and commissions paid;
- a decrease in sales volumes, which could result in lower gross margins as driven by lower absorption of manufacturing costs
- a change in accounting standards or practices that may impact us to a greater degree than other companies due to our product mix, which would impact revenue recognition, or our borrowing structure;
- a change in existing taxation rules or practices due to our specific operating structure that may not be comparable to other companies; and
- a shortfall in sales without a proportional decrease in expenses.

We may face product-failure exposure.

Our products are complex and may contain defects or experience failures due to any number of issues in design, materials, deployment and/or use. If any of our products contain a defect, compatibility or interoperability issue or other error, we may have to devote significant time and resources to find and correct the issue. We provide product warranties for varying lengths of time and establish allowances in anticipation of warranty expenses. In addition, we record contingent liabilities for additional product-failure related costs. These warranty and related product-failure allowances may be inadequate due to product defects, unanticipated component failures, as well as higher than anticipated material, labor, and other costs we may incur to replace projected product failures. A product recall or a significant number of product returns could be expensive; damage our reputation and relationships with utilities, meter and communication vendors, and other third-party vendors; result in the loss of business to competitors; or result in litigation against us. We may incur additional warranty and related expenses in the future with respect to new or established products, which could materially and adversely affect our operations and financial position.

Our customer contracts may contain provisions that could cause us to incur penalties, be liable for damages, and/or incur unanticipated expenses with respect to the functionality, deployment, operation, and availability of our products and services.

In addition to the risk of unanticipated warranty or recall expenses, our customer contracts may contain provisions that could cause us to incur penalties, be liable for damages, including liquidated damages, or incur other expenses, if we experience difficulties with respect to the functionality, deployment, operation, and availability of our products and services. In the event of late deliveries, late or improper installations or operations, failure to meet product or performance specifications or other product defects, or interruptions or delays in our managed service offerings, our customer contracts may expose us to penalties, liquidated damages, and other liabilities. In the event we were to incur contractual penalties, such as liquidated damages or other related costs that exceed our expectations, our business, financial condition, and operating results could be materially and adversely affected.

We depend on our ability to develop new competitive products.

Our future success will depend, in part, on our ability to continue to design and manufacture new competitive products and to enhance and sustain our existing products, keep pace with technological advances and changing customer requirements, gain international market acceptance, and manage other factors in the markets in which we sell our products. Product development will require continued investment in order to maintain our competitive position, and the periods in which we incur significant product development costs may drive variability in our quarterly results. We may not have the necessary capital, or access to capital at acceptable terms, to make these investments. We have made, and expect to continue to make, substantial investments in technology development. However, we may experience unforeseen problems in the development or performance of our technologies or products. In addition, we may not meet our product development schedules. New products often require certifications or regulatory approvals before the products can be used and we cannot be certain that our new products will be approved in a timely manner. Finally, we may not achieve market acceptance of our new products and services.

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We are affected by the availability and regulation of radio spectrum and interference with the radio spectrum that we use.

A significant number of our products use radio spectrum, which are subject to regulation by the Federal Communications Commission (FCC) in the United States. The FCC may adopt changes to the rules for our licensed and unlicensed frequency bands that are incompatible with our business. In the past, the FCC has adopted changes to the requirements for equipment using radio spectrum, and it is possible that the FCC or the U.S. Congress will adopt additional changes.

Although radio licenses are generally required for radio stations, Part 15 of the FCC's rules permits certain low-power radio devices (Part 15 devices) to operate on an unlicensed basis. Part 15 devices are designed for use on frequencies used by others. These other users may include licensed users, which have priority over Part 15 users. Part 15 devices cannot cause harmful interference to licensed users and must be designed to accept interference from licensed radio devices. In the United States, our advanced and smart metering systems are typically Part 15 devices that transmit information to (and receive information from, if applicable) handheld, mobile, or fixed network systems pursuant to these rules.

The FCC has initiated a rulemaking proceeding in which it is considering adopting "spectrum etiquette" requirements for unlicensed Part 15 devices operating in the 902-928 MHz band, which many of our advanced and smart metering systems utilize. The outcome of the proceeding may require us to make material changes to our equipment.

The FCC has also adopted service rules governing the use of the 1427-1432 MHz band. We use this band with various devices in our network solutions. Among other things, the rules reserve parts of the band for general telemetry, including utility telemetry, and provide that nonexclusive licenses will be issued in accordance with Part 90 rules and the recommendations of frequency coordinators. Telemetry licensees must comply with power limits and out-of-band emission requirements that are designed to avoid interference with other users of the band. The FCC issues licenses on a nonexclusive basis and it is possible that the demand for spectrum will exceed supply.

We depend upon sufficient radio spectrum to be allocated by the FCC for our intended uses. As to the licensed frequencies, there is some risk that there may be insufficient available frequencies in some markets to sustain our planned operations. The unlicensed frequencies are available for a wide variety of uses and may not be entitled to protection from interference by other users who operate in accordance with FCC rules. The unlicensed frequencies are also often the subject of proposals to the FCC requesting a change in the rules under which such frequencies may be used. If the unlicensed frequencies become crowded to unacceptable levels, restrictive, or subject to changed rules governing their use, our business could be materially adversely affected.

We have committed, and will continue to commit, significant resources to the development of products that use particular radio frequencies. Action by the FCC could require modifications to our products. The inability to modify our products to meet such requirements, the possible delays in completing such modifications, and the cost of such modifications all could have a material adverse effect on our future business, financial condition, and results of operations.

Outside of the United States, certain of our products require the use of RF and are subject to regulations in those jurisdictions where we have deployed such equipment. In some jurisdictions, radio station licensees are generally required to operate a radio transmitter and such licenses may be granted for a fixed term and must be periodically renewed. In other jurisdictions, the rules permit certain low power devices to operate on an unlicensed basis. Our advanced and smart metering systems typically transmit to (and receive information from, if applicable) handheld, mobile, or fixed network reading devices in unlicensed bands pursuant to rules regulating such use. Generally, we use the unlicensed Industrial, Scientific, and Medical (ISM) bands with the various reading devices in our solutions. In

Europe, we generally use the 433 MHz and 868 MHz bands. In the rest of the world, we primarily use the 433 MHz and 2.4000-2.4835 GHz bands, as well as other local unlicensed bands. To the extent we introduce new products designed for use in the United States or another country into a new market, such products may require significant modification or redesign in order to meet frequency requirements and other regulatory specifications. In some countries, limitations on frequency availability or the cost of making necessary modifications may preclude us from selling our products in those countries. In addition, new consumer products may create interference with the performance of our products, which could lead to claims against us.

We may face adverse publicity, consumer or political opposition, or liability associated with our products.

The safety and security of the power grid, the accuracy and protection of the data collected by meters and transmitted via the smart grid, concerns about the safety and perceived health risks of using radio frequency communications, and privacy concerns of monitoring home appliance energy usage have been the focus of recent adverse publicity. Negative publicity and consumer opposition may cause utilities or their regulators to delay or modify planned smart grid initiatives. Smart grid projects may be, or may be perceived as, unsuccessful.

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We may be subject to claims that there are adverse health effects from the radio frequencies utilized in connection with our products. If these claims prevail, our customers could suspend implementation or purchase substitute products, which could cause a loss of sales.

We are facing increasing competition.

We face competitive pressures from a variety of companies in each of the markets we serve. Some of our present and potential future competitors have, or may have, substantially greater financial, marketing, technical, or manufacturing resources and, in some cases, have greater name recognition, customer relationships, and experience. Some competitors may enter markets we serve and sell products at lower prices in order to gain or grow market share. Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements. They may also be able to devote greater resources to the development, promotion, and sale of their products and services than we can. Some competitors have made, and others may make, strategic acquisitions or establish cooperative relationships among themselves or with third parties that enhance their ability to address the needs of our prospective customers. It is possible that new competitors or alliances among current and new competitors may emerge and rapidly gain significant market share. Other companies may also drive technological innovation and develop products that are equal in quality and performance or superior to our products, which could put pressure on our market position, reduce our overall sales, and require us to invest additional funds in new technology development. In addition, there is a risk that low-cost providers will enter, or form alliances or cooperative relationships with our competitors, thereby contributing to future price erosion. Some of our products and services may become commoditized and we may have to adjust the prices of some of our products to stay competitive. Should we fail to compete successfully with current or future competitors, we could experience material adverse effects on our business, financial condition, results of operations, and cash flows.

We are subject to regulatory compliance.

We are subject to various governmental regulations in all of the jurisdictions in which we conduct business. Failure to comply with current or future regulations could result in the imposition of substantial fines, suspension of production, alteration of our production processes, cessation of operations, or other actions, which could materially and adversely affect our business, financial condition, and results of operations.

Changes in environmental regulations, violations of such regulations, or future environmental liabilities could cause us to incur significant costs and could adversely affect our operations.

Our business and our facilities are subject to numerous laws, regulations, and ordinances governing, among other things, the storage, discharge, handling, emission, generation, manufacture, disposal, remediation of, and exposure to toxic or other hazardous substances, and certain waste products. Many of these environmental laws and regulations subject current or previous owners or operators of land to liability for the costs of investigation, removal, or remediation of hazardous materials. In addition, these laws and regulations typically impose liability regardless of whether the owner or operator knew of, or was responsible for, the presence of any hazardous materials and regardless of whether the actions that led to the presence were conducted in compliance with the law. In the ordinary course of our business, we use metals, solvents, and similar materials, which are stored on-site. The waste created by the use of these materials is transported off-site on a regular basis by unaffiliated waste haulers. Many environmental laws and regulations require generators of waste to take remedial actions at, or in relation to, the off-site disposal location even if the disposal was conducted in compliance with the law. The requirements of these laws and regulations are complex, change frequently, and could become more stringent in the future. Failure to comply with current or future environmental regulations could result in the imposition of substantial fines, suspension of production, alteration of our production processes, cessation of operations, or other actions, which could materially and adversely affect our business, financial condition, and results of operations. There can be no assurance that a claim, investigation, or liability will not arise with respect to these activities, or that the cost of complying with governmental regulations in the future will not have a material adverse effect on us.

New regulations related to “conflict minerals” may force us to incur additional expenses, may result in damage to our business reputation, and may adversely impact our ability to conduct our business.

In August 2012, under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the SEC adopted new requirements for companies that use certain minerals and derivative metals (referred to as “conflict minerals,” regardless of their actual country of origin) in their products. Some of these metals are commonly used in electronic equipment and devices, including our products. These new requirements will require companies to investigate, disclose and report whether or not such metals originated from the Democratic Republic of Congo or adjoining countries and will require due diligence efforts in fiscal 2013, with initial disclosure requirements beginning in May 2014. There will be costs associated with complying with these disclosure requirements, including for diligence to determine the sources of conflict minerals used in our products and other potential changes to products, processes or sources of supply as a consequence of such verification activities. The implementation of these rules could adversely affect the sourcing, supply, and pricing of materials used in our products.

Our international sales and operations are subject to complex laws relating to foreign corrupt practices and anti-bribery laws, among many others, and a violation of, or change in, these laws could adversely affect our operations.

The Foreign Corrupt Practices Act in the United States requires United States companies to comply with an extensive legal framework to prevent bribery of foreign officials. The laws are complex and require that we closely monitor local practices of our overseas offices. The United States Department of Justice has recently heightened enforcement of these laws. In addition, other countries continue to implement similar laws that may have extra-territorial effect. In the United Kingdom, where we have operations, the U.K. Bribery Act imposes significant oversight obligations on us and could impact our operations outside of the United Kingdom. The costs for complying with these and similar laws may be significant and could require significant management time and focus. Any violation of these or similar laws, intentional or unintentional, could have a material adverse effect on our business, financial condition, or results of operations.

Disruption and turmoil in global credit and financial markets, which may be exacerbated by the inability of certain countries to continue to service their sovereign debt obligations, and the possible negative implications of such events for the global economy, may negatively impact our business, operating results, and financial condition.

The recent downgrade of the U.S. credit rating and the possibility that some European Union (EU) member states will default on their debt obligations have contributed to significant uncertainty about the stability of global credit and financial markets. The credit and economic conditions within some EU countries including Greece, Ireland, Italy, Portugal, and Spain, have contributed to the instability in some global credit and financial markets. While the ultimate outcome of these events cannot be predicted, it is possible that such events may have a negative impact on the global economy and our business, operating results, and financial condition.

We are subject to international business uncertainties, obstacles to the repatriation of earnings, and foreign currency fluctuations.

A substantial portion of our revenues is derived from operations conducted outside the United States. International sales and operations may be subjected to risks such as the imposition of government controls, government expropriation of facilities, lack of a well-established system of laws and enforcement of those laws, access to a legal system free of undue influence or corruption, political instability, terrorist activities, restrictions on the import or export of critical technology, currency exchange rate fluctuations, and adverse tax burdens. Lack of availability of qualified third-party financing, generally longer receivable collection periods than those commonly practiced in the United States, trade restrictions, changes in tariffs, labor disruptions, difficulties in staffing and managing international operations, difficulties in imposing and enforcing operational and financial controls at international locations, potential insolvency of international distributors, preference for local vendors, burdens of complying with different permitting standards and a wide variety of foreign laws, and obstacles to the repatriation of earnings and cash all present additional risk to our international operations. Fluctuations in the value of international currencies may impact our operating results due to the translation to the U.S. dollar as well as our ability to compete in international markets. International expansion and market acceptance depend on our ability to modify our technology to take into account such factors as the applicable regulatory and business environment, labor costs, and other economic conditions. In addition, the laws of certain countries do not protect our products or technologies in the same manner as the laws of the United States. There can be no assurance that these factors will not have a material adverse effect on our future international sales and, consequently, on our business, financial condition, and results of operations.

We depend on certain key vendors and components.

Certain of our products, subassemblies, and system components are procured from limited sources. Our reliance on such limited sources involves certain risks, including the possibility of shortages and reduced control over delivery schedules, quality, costs, and our vendors' access to capital upon acceptable terms. Any adverse change in the supply, or price, of these components could adversely affect our business, financial condition, and results of operations. In addition, we depend on a small number of contract manufacturing vendors for a large portion of our low-volume manufacturing business and all of our repair services for our domestic handheld meter reading units. Should any of these vendors become unable to perform up to their responsibilities, our operations could be materially disrupted.

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Business interruptions could adversely affect our business.

Our worldwide operations could be subject to hurricanes, tornadoes, earthquakes, floods, fires, extreme weather conditions, medical epidemics or pandemics, or other natural or man-made disasters or business interruptions. The occurrence of any of these business disruptions could seriously harm our business, financial condition, and results of operations.

Our key manufacturing facilities are concentrated and in the event of a significant interruption in production at any of our manufacturing facilities, considerable expense, time, and effort could be required to establish alternative production lines to meet contractual obligations, which would have a material adverse effect on our business, financial condition, and results of operations.

Asset impairment could result in significant changes that would adversely impact our future operating results.

We have significant intangible assets, long-lived assets, goodwill, and deferred tax assets that are susceptible to valuation adjustments as a result of changes in various factors or conditions.

We assess impairment of amortizable intangible and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that could trigger an impairment of such assets include the following:

- underperformance relative to projected future operating results;
- changes in the manner or use of the acquired assets or the strategy for our overall business;
- negative industry or economic trends;
- decline in our stock price for a sustained period or decline in our market capitalization below net book value; and
- changes in our organization or management reporting structure, which could result in additional reporting units, requiring greater aggregation or disaggregation in our analysis by reporting unit and potentially alternative methods/assumptions of estimating fair values.

We assess the potential impairment of goodwill each year as of October 1. We also assess the potential impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Adverse changes in economic conditions or our operations could affect the assumptions we use to calculate the fair value, which in turn could result in an impairment charge in future periods that would impact our results of operations and financial position in that period.

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

We may face losses associated with alleged unauthorized use of third party intellectual property.

We may be subject to claims or inquiries regarding alleged unauthorized use of a third party’s intellectual property. An adverse outcome in any intellectual property litigation or negotiation could subject us to significant liabilities to third parties, require us to license technology or other intellectual property rights from others, require us to comply with injunctions to cease marketing or the use of certain products or brands, or require us to redesign, re-engineer, or rebrand certain products or packaging, any of which could affect our business, financial condition, and results of operations. If we are required to seek licenses under patents or other intellectual property rights of others, we may not be able to acquire these licenses at acceptable terms, if at all. In addition, the cost of responding to an intellectual property infringement claim, in terms of legal fees, expenses, and the diversion of management resources, whether or not the claim is valid, could have a material adverse effect on our business, financial condition, and results of operations.

If our products infringe the intellectual property rights of others, we may be required to indemnify our customers for any damages they suffer. We generally indemnify our customers with respect to infringement by our products of the proprietary rights of third parties. Third parties may assert infringement claims against our customers. These claims may require us to initiate or defend protracted and costly litigation on behalf of our customers, regardless of the merits of these claims. If any of these claims succeed, we may be forced to pay damages on behalf of our customers or may be required to obtain licenses for the products they use. If we cannot obtain all necessary licenses on commercially reasonable terms, our customers may be forced to stop using our products.

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We may be unable to adequately protect our intellectual property.

While we believe that our patents and other intellectual property have significant value, it is uncertain that this intellectual property or any intellectual property acquired or developed by us in the future will provide meaningful competitive advantages. There can be no assurance that our patents or pending applications will not be challenged, invalidated, or circumvented by competitors or that rights granted thereunder will provide meaningful proprietary protection. Moreover, competitors may infringe our patents or successfully avoid them through design innovation. To combat infringement or unauthorized use of our intellectual property, we may need to commence litigation, which can be expensive and time-consuming. In addition, in an infringement proceeding a court may decide that a patent or other intellectual property right of ours is not valid or is unenforceable, or may refuse to stop the other party from using the technology or other intellectual property right at issue on the grounds that it is non-infringing or the legal requirements for an injunction have not been met. Policing unauthorized use of our intellectual property is difficult and expensive, and we cannot provide assurance that we will be able to prevent misappropriation of our proprietary rights, particularly in countries that do not protect such rights in the same manner as in the United States.

We are subject to a variety of litigation that could adversely affect our results of operations and financial condition.

From time to time, we are involved in litigation that arises from our business. Litigation may, for example, relate to alleged infringements of intellectual property rights of others. Non-practicing entities may also make infringement claims in order to reach a settlement with us. In addition, these entities may bring claims against our customers, which, in some instances, could result in an indemnification of the customer. Litigation may also relate to product failure or product liability claims, contractual disputes, employment matters, or securities litigation. Litigation can be expensive to defend and can divert the attention of management and other personnel for long periods of time, regardless of the ultimate outcome. We may be required to pay damage awards or settlements or become subject to equitable remedies that could adversely affect our financial condition and results of operations. While we currently maintain insurance coverage, such insurance may not provide adequate coverage against potential claims.

A number of key personnel are critical to the success of our business.

Our success depends in large part on the efforts of our highly qualified technical and management personnel and highly skilled individuals in all disciplines. The loss of one or more of these employees and the inability to attract and retain qualified replacements could have a material adverse effect on our business.

We may not realize the expected benefits from strategic alliances.

We have several strategic alliances with large and complex organizations and other companies with which we work to offer complementary products and services. There can be no assurance we will realize the expected benefits from these strategic alliances. If successful, these relationships may be mutually beneficial and result in shared growth. However, alliances carry an element of risk because, in most cases, we must both compete and collaborate with the same company from one market to the next. Should our strategic partnerships fail to perform, we could experience delays in product development or experience other operational difficulties.

Our acquisitions of and investments in third parties have risks.

We may complete additional acquisitions or make investments in the future, both within and outside of the United States. In order to finance future acquisitions, we may need to raise additional funds through public or private financings, and there are no assurances that such financing would be available at acceptable terms. Acquisitions and investments involve numerous risks such as the diversion of senior management’s attention; unsuccessful integration of the acquired entity’s personnel, operations, technologies, and products; incurrence of significant expenses to meet an acquiree's customer contractual commitments; lack of market acceptance of new services and technologies; or difficulties in operating businesses in international legal jurisdictions. Failure to properly or adequately address these issues could result in the diversion of management’s attention and resources and materially and adversely impact our ability to manage our business. In addition, acquisitions and investments in third parties may involve the assumption of obligations, significant write-offs, or other charges associated with the acquisition. Impairment of an investment, goodwill, or an intangible asset may result if these risks were to materialize. For investments in entities that are not wholly owned by Itron, such as joint ventures, a loss of control as defined by U.S. generally accepted accounting principles (GAAP) could result in a significant change in accounting treatment and a change in the carrying value of the entity. There can be no assurances that an acquired business will perform as expected, accomplish our strategic objectives, or generate significant revenues, profits, or cash flows.

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We rely on information technology systems.

Our industry requires the continued operation of sophisticated information technology systems and network infrastructures, which may be subject to disruptions arising from events that are beyond our control. We are dependent on information technology systems, including, but not limited to, networks, applications, and outsourced services. We continually enhance and implement new systems and processes throughout our global operations.

We offer managed services and software utilizing several data center facilities located worldwide. Any damage to, or failure of, these systems could result in interruptions in the services we provide to our utility customers. As we continue to add capacity to our existing and future data centers, we may move or transfer data. Despite precautions taken during this process, any delayed or unsuccessful data transfers may impair the delivery of our services to our utility customers. We also sell vending and pre-payment systems with security features that, if compromised, may lead to claims against us.

We are completing a phased upgrade of our primary enterprise resource planning (ERP) systems to allow for greater depth and breadth of functionality worldwide. System conversions are expensive and time consuming undertakings that impact all areas of the Company. While successful implementations of each phase will provide many benefits to us, an unsuccessful or delayed implementation of any particular phase may cost us significant time and resources, as well as expense.

The failure of these systems to operate effectively, problems with transitioning to upgraded or replacement systems, or a breach in security of these systems due to computer viruses, hacking, acts of terrorism, and other causes could materially and adversely affect our business, financial condition, and results of operations by harming our ability to accurately forecast sales demand, manage our supply chain and production facilities, achieve accuracy in the conversion of electronic data and records, and report financial and management information on a timely and accurate basis. In addition, due to the systemic internal control features within ERP systems, we may experience difficulties that could affect our internal control over financial reporting.

Changes in tax laws and unanticipated tax liabilities could adversely affect our effective income tax rate and profitability.

We are subject to income tax in the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves may be established when we believe that certain positions might be challenged despite our belief that our tax return positions are fully supportable. We adjust these reserves in light of changing facts and circumstances, such as the outcome of tax audits. The provision for income taxes includes the impact of reserve positions and changes to reserves that are considered appropriate. We regularly assess all of these matters to determine the adequacy of our tax provision, which is subject to significant judgment.

Our credit facility limits our ability and the ability of many of our subsidiaries to take certain actions.

Our credit facility places restrictions on our ability, and the ability of many of our subsidiaries to, among other things:

- incur more debt;
- make certain investments;
- enter into transactions with affiliates;
- merge or consolidate;
- pay dividends, make distributions, and repurchase capital stock;
- create liens;
- enter into sale lease-back transactions;
- transfer or sell assets.

Our credit facility contains other customary covenants, including the requirement to meet specified financial ratios. Our ability to borrow under our credit facility will depend on the satisfaction of these covenants. Events beyond our control can affect our ability to meet those covenants. Our failure to comply with obligations under our borrowing arrangements may result in declaration of an event of default. An event of default, if not cured or waived, may permit acceleration of required payments against such indebtedness. We cannot be certain we will be able to remedy any such defaults. If our required payments are accelerated, we cannot be certain that we will have sufficient funds available to pay the indebtedness or that we will have the ability to raise sufficient capital to replace the indebtedness on terms favorable to us or at all. In addition, in the case of an event of default under our secured indebtedness such as our credit facility, the lenders may be permitted to foreclose on our assets securing that indebtedness.

Our credit facility is sensitive to interest rate fluctuations that could impact our financial position and results of operations.

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Our ability to service our indebtedness is dependent on our ability to generate cash, which is influenced by many factors beyond our control.

Our ability to make payments on or refinance our indebtedness, fund planned capital expenditures, and continue research and development will depend on our ability to generate cash in the future. This is dependent on the degree to which we succeed in executing our business plans, which is influenced, in part, by general economic, financial, competitive, legislative, regulatory, counterparty, and other risks that are beyond our control. We may need to refinance all or a portion of our indebtedness on or before maturity. We cannot provide assurance that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all.

We are exposed to counterparty default risks with our financial institutions and insurance providers.

The financial strength of some depository institutions has diminished and this trend may continue. If one or more of the depository institutions in which we maintain significant cash balances were to fail, our ability to access these funds might be temporarily or permanently limited, and we could face material liquidity problems and financial losses.

The lenders of our credit facility consist of several participating financial institutions. Our revolving line of credit allows us to provide letters of credit in support of our obligations for customer contracts and provides additional liquidity. If our lenders are not able to honor their line of credit commitments due to the loss of a participating financial institution or other circumstance, we would need to seek alternative financing, which may not be under acceptable terms, and therefore could adversely impact our ability to successfully bid on future sales contracts and adversely impact our liquidity and ability to fund some of our internal initiatives or future acquisitions.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

Effective internal controls are necessary for us to provide reliable and accurate financial reports and effectively prevent fraud. We have devoted significant resources and time to comply with the internal control over financial reporting requirements of the Sarbanes-Oxley Act. In addition, Section 404 under the Sarbanes-Oxley Act requires that our auditors attest to the design and operating effectiveness of our controls over financial reporting. Our compliance with the annual internal control report requirement for each fiscal year will depend on the effectiveness of our financial reporting, data systems, and controls across our operating subsidiaries. Furthermore, an important part of our growth strategy has been, and will likely continue to be, the acquisition of complementary businesses, and we expect these systems and controls to become increasingly complex to the extent that we integrate acquisitions and our business grows. Likewise, the complexity of our transactions, systems, and controls may become more difficult to manage. We cannot be certain that these measures will ensure that we design, implement, and maintain adequate controls over our financial processes and reporting in the future, especially for acquisition targets that may not have been required to be in compliance with Section 404 of the Sarbanes-Oxley Act at the date of acquisition. Any failure to implement required new or improved controls, difficulties encountered in their implementation or operation, or difficulties in the assimilation of acquired businesses into our control system could harm our operating results or cause it to fail to meet our financial reporting obligations. Inadequate internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock and our access to capital.

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ITEM 1B: UNRESOLVED STAFF COMMENTS

None.

ITEM 2: PROPERTIES

The following table lists the number of manufacturing facilities, service and distribution locations, and offices by region.

	Manufacturing		Service and Distribution		Offices	
	Owned	Leased	Owned	Leased	Owned	Leased
North America	3	—	—	6	1	18
Europe	10	4	—	2	3	24
Asia/Pacific	2	4	—	4	—	20
Other	2	2	1	1	—	10
Total	17	10	1	13	4	72

Our major manufacturing facilities are owned, while smaller factories are typically leased. Our service and distribution locations typically consist of assembly, service, and/or distribution, and may also include product development and administrative functions. Our office locations consist primarily of sales and administration functions, and may also include research and development functions. Our Energy facilities are located throughout the world, and our Water facilities are located primarily in Asia/Pacific and Europe, with the balance primarily in South America. We own our headquarters facility, which is located in Liberty Lake, Washington. Our principal properties are owned and in good condition, and we believe our current facilities are sufficient to support our operations.

In October 2011, we announced projects to restructure our manufacturing operations in order to increase efficiency and lower our cost of manufacturing, including projects to close or consolidate several of our manufacturing facilities. As part of the restructuring in North America, one owned manufacturing facility and one leased distribution facility were vacated during 2012. The manufacturing facility is fully leased to an unrelated third party. Both of these facilities are excluded from the table above because they do not currently contribute to our operations. In addition, three facilities in Europe ceased manufacturing operations during 2012. These three facilities were transferred to the "Offices" category in the table above. These facilities are expected to be sold in the future.

An additional manufacturing facility in Europe was vacated in 2012 when the operations and personnel transferred to a new leased manufacturing facility. The vacant facility is expected to be sold, and, because the facility does not contribute to our operations, it has been excluded from the table above.

ITEM 3: LEGAL PROCEEDINGS

There are no material pending legal proceedings, as defined by Item 103 of Regulation S-K, at December 31, 2012.

ITEM 4: MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information for Common Stock

Our common stock is traded on the NASDAQ Global Select Market. The following table reflects the range of high and low common stock sales prices for the four quarters of 2012 and 2011 as reported by the NASDAQ Global Select Market.

	2012		2011	
	High	Low	High	Low
First Quarter	$48.23	$36.60	$64.04	$51.12
Second Quarter	$45.42	$33.50	$55.99	$46.68
Third Quarter	$45.85	$38.28	$49.40	$29.50
Fourth Quarter	$45.26	$38.71	$38.49	$27.52

Performance Graph

The following graph compares the five-year cumulative total return to shareholders on our common stock with the five-year cumulative total return of our peer group of companies used for the year ended December 31, 2012 and the NASDAQ Composite Index.

* $100 invested on 12/31/07 in stock or index, including investment of dividends.

Fiscal years ending December 31.

The above presentation assumes $100 invested on December 31, 2007 in the common stock of Itron, Inc., the peer group, and the NASDAQ Composite Index, with all dividends reinvested. With respect to companies in the peer group, the returns of each such corporation have been weighted to reflect relative stock market capitalization at the beginning of each annual period plotted. The stock prices shown above for our common stock are historical and not necessarily indicative of future price performance.

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Each year, we reassess our peer group to identify global companies that are either direct competitors or have similar industry and business operating characteristics. Our 2012 peer group includes the following publicly traded companies: Badger Meter, Inc., Echelon Corporation, ESCO Technologies Inc., National Instruments Corporation, and Roper Industries, Inc. Cooper Industries, Ltd. and Elster Group SE are no longer included in our peer group because they were acquired by other companies in 2012.

Issuer Repurchase of Equity Securities

The table below summarizes information about the Company's purchases of its shares of common stock, based on settlement date, during the quarterly period ended December 31, 2012.

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share[2]	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
October 1 through October 31	157,772	$42.73	157,772	$23,131
November 1 through November 30	—	—	—	23,131
December 1 through December 31	—	—	—	23,131
Total	157,772	$42.73	157,772	

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

(2) Includes commissions.

We did not repurchase any stock from January 1, 2013 through February 15, 2013, when the stock repurchase program expired.

Holders

At January 31, 2013, there were 272 holders of record of our common stock.

Dividends

Since the inception of the Company, we have not declared or paid cash dividends. We intend to retain future earnings for the development of our business and do not anticipate paying cash dividends in the foreseeable future.

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ITEM 6: SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data below is derived from our consolidated financial statements, which have been audited by an independent registered public accounting firm. These selected consolidated financial and other data represent portions of our financial statements. You should read this information together with Item 7: “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Item 8: “Financial Statements and Supplementary Data” included in this Annual Report on Form 10-K. Historical results are not necessarily indicative of future performance.

	Year Ended December 31,				
	2012	2011[2]	2010	2009	2008
	(in thousands, except per share data)				
Consolidated Statements of Operations Data					
Revenues	$2,178,178	$2,434,124	$2,259,271	$1,687,447	$1,909,613
Cost of revenues	1,463,031	1,687,666	1,558,596	1,147,484	1,260,586
Gross profit	715,147	746,458	700,675	539,963	649,027
Operating income (loss)	151,126	(459,183)	184,197	45,027	109,822
Net income (loss) attributable to Itron, Inc.	108,275	(510,157)	104,770	(2,249)	19,811
Earnings (loss) per common share - Basic	$2.73	$(12.56)	$2.60	$(0.06)	$0.60
Earnings (loss) per common share - Diluted	$2.71	$(12.56)	$2.56	$(0.06)	$0.57
Weighted average common shares outstanding - Basic	39,625	40,612	40,337	38,539	33,096
Weighted average common shares outstanding - Diluted	39,934	40,612	40,947	38,539	34,951
Consolidated Balance Sheets Data					
Working capital[1]	$353,577	$329,632	$178,483	$282,532	$293,296
Total assets	2,089,441	2,064,282	2,745,797	2,854,621	2,856,348
Total debt	417,500	452,502	610,941	781,764	1,151,767
Total Itron, Inc. shareholders' equity	992,967	906,925	1,428,295	1,400,514	1,058,776
Other Financial Data					
Cash provided by operating activities	$205,090	$252,358	$254,591	$140,787	$193,146
Cash used in investing activities[3]	(125,445)	(78,741)	(56,274)	(53,994)	(67,075)
Cash used in financing activities	(77,528)	(209,453)	(148,637)	(114,121)	(63,376)
Capital expenditures	(50,543)	(60,076)	(62,822)	(52,906)	(63,430)

(1) Working capital represents current assets less current liabilities.

(2) During 2011, we incurred a goodwill impairment charge of $584.8 million. In addition, restructuring projects were approved and commenced to increase efficiency and lower our cost of manufacturing, for which we incurred costs of $68.1 million in 2011.

(3) On May 1, 2012, we completed our acquisition of SmartSynch, Inc. for $77.7 million in cash (net of $6.7 million of cash and cash equivalents acquired).

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

The following discussion and analysis should be read in conjunction with Item 8: “Financial Statements and Supplementary Data.”

Overview

We are a technology company, offering end-to-end smart metering solutions to electric, natural gas, and water utilities around the world. Our smart metering solutions, meter data management software, and knowledge application solutions bring additional value to a utility’s metering and grid systems. Our professional services help our customers project-manage, install, implement, operate, and maintain their systems.

As part of our global reorganization announced in the first quarter of 2011, we now manage and report under two operating segments, Energy and Water. The transition to the new organizational structure, including changes to operations, as well as financial and operational management systems, was completed in the first quarter of 2012. Our historical segment information for the years ended December 31, 2011 and 2010 has been recast to reflect our new operating segments.

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

On May 1, 2012, we completed our acquisition of SmartSynch, Inc. (SmartSynch). SmartSynch provides smart grid solutions that utilize cellular networks for communications. The acquisition strengthens our cellular communications offerings, and we believe the acquisition brings greater choice to utility customers across the spectrum of smart metering deployments. For further details regarding the acquisition of SmartSynch, refer to Item 8: "Financial Statements and Supplementary Data, Note 17: Business Combinations."

We have three measures of segment performance: revenue, gross profit (margin), and operating income (margin). Intersegment revenues were minimal. Corporate operating expenses, interest income, interest expense, other income (expense), and income tax provision (benefit) are not allocated to the segments, nor included in the measure of segment profit or loss.

Revenues decreased 11% in 2012, compared with 2011. The revenue decrease was due primarily to the completion of several large OpenWay® projects in the Energy segment, partially offset by a 1% increase in revenues in the Water segment. Revenues increased 8% in 2011, compared with 2010. The 2011 revenue growth was driven by our Energy operating segment with an increase of $111.1 million, or 6%, in revenues in 2011, compared with 2010, while our Water operating segment increased $63.8 million, or 14%, from 2010.

Total backlog was $1.0 billion and twelve-month backlog was $568 million at December 31, 2012.

Total company gross margin increased 210 basis points in 2012, compared with 2011. Gross margin improvement over the prior year was driven by lower warranty costs in both the Energy and Water segments. Additionally, benefits from our restructuring actions and manufacturing efficiencies offset the impact of decreased volumes. Total company gross margin decreased 30 basis points in 2011, compared with 2010, primarily due to increased warranty charges in the Energy and Water operating segments.

Our restructuring projects continue as planned, and we expect to substantially complete these projects by the end of 2013, although we expect the disposition of certain manufacturing sites may require additional time beyond that date.

Since the announcement of these projects in October 2011, we have incurred $69.8 million in costs, representing approximately 90% of the total expected costs. Total expected costs decreased by $7.7 million from December 31, 2011 to December 31, 2012, primarily as the result of gains on the dispositions of fixed assets and a correction to the amount of goodwill allocated to one of our non-core businesses sold as part of the restructuring process. In addition, expected severance costs were reduced as the result of certain employees, in positions that were eliminated under the restructuring project, filling vacant positions within the Company. Net restructuring expense of $1.7 million was recognized in 2012, primarily related to severance and environmental cleanup costs for sites expected to be sold, offset by the $5.4 million correction to the goodwill impairment. Restructuring expenses of $68.1 million were recognized in 2011, associated with severance accruals, the impairment of long-lived assets that will be sold, and other facility exit costs. For further details regarding the correction of the goodwill impairment, refer to Item 8: "Financial Statements and Supplementary Data, Note 5: Goodwill." We have begun to realize benefits from our restructuring projects during 2012, and we expect full realization of the cost savings by the end of 2013 and into 2014. Revenues and net operating income from the activities we have exited or will exit under the restructuring plan are not material to our operating segments or consolidated results.

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

	Year Ended December 31,				
	2012	% Change	2011	% Change	2010
	(in thousands)		(in thousands)		(in thousands)
Revenues	$2,178,178	(11)%	$2,434,124	8%	$2,259,271
Gross Profit	$715,147	(4)%	$746,458	7%	$700,675
Gross Margin	32.8 %		30.7 %		31.0 %

	Year Ended December 31,		
	2012	2011	2010
	(in thousands)		
Revenues by region			
United States and Canada	$1,014,739	$1,182,775	$1,168,523
Europe, Middle East, and Africa (EMEA)	878,615	899,642	803,154
Other	284,824	351,707	287,594
Total revenues	$2,178,178	$2,434,124	$2,259,271

Revenues
Revenues decreased 11%, or $255.9 million, in 2012, compared with 2011. Revenues in 2012 were lower, primarily driven by the substantial completion of four of our five largest OpenWay projects in the Energy segment and by $92.2 million in the unfavorable net translation impact of operations denominated in foreign currencies, partially offset by an increase in Water revenues during the year. Revenues increased 8%, or $174.9 million, in 2011, compared with 2010. The net translation effect of our operations denominated in foreign currencies accounted for $60.6 million of the increase in revenues for the year ended December 31, 2011, compared with 2010. A more detailed analysis of these fluctuations is provided in Operating Segment Results.

No single customer represented more than 10% of total revenues for the years ended December 31, 2012 and 2011. For the year ended December 31, 2010, one customer within our Energy operating segment, Southern California Edison, represented 11% of total revenues. Our 10 largest customers accounted for 27%, 33%, and 34% of total revenues in 2012, 2011, and 2010.

Gross Margins
Gross margin was 32.8% for 2012, compared with 30.7% in 2011. The improvement was primarily the result of lower warranty costs in 2012 in both the Energy and Water segments, which positively impacted gross margin by 170 basis points. Benefits from our restructuring projects and manufacturing efficiencies offset the impact of decreased volumes. Gross margin decreased by 30 basis points in 2011 when compared with 2010, primarily due to warranty charges incurred in the Energy and Water operating segments. A more detailed analysis of these fluctuations is provided in Operating Segment Results.

Meter and Module Summary
We classify meters into three categories:

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

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In addition, advanced and smart meter communication modules can be sold separately from the meter. A summary of our meter and communication module shipments is as follows:

	Year Ended December 31,		
	2012	2011	2010
	(units in thousands)		
Meters			
Standard	17,920	19,570	20,010
Advanced and smart	8,030	9,320	8,440
Total meters	25,950	28,890	28,450
Stand-alone communication modules			
Advanced and smart	6,460	6,330	5,960

Operating Segment Results

For a description of our operating segments, refer to Item 8: "Financial Statements and Supplementary Data, Note 16: Segment Information" in this Annual Report on Form 10-K. The following tables and discussion highlight significant changes in trends or components of each operating segment.

	Year Ended December 31,				
	2012	% Change	2011	% Change	2010
Segment Revenues	(in thousands)		(in thousands)		(in thousands)
Energy					
Electricity	$1,024,340	(17)%	$1,239,428	5%	$1,185,892
Gas	627,193	(7)%	672,999	9%	615,450
Total Energy	1,651,533	(14)%	1,912,427	6%	1,801,342
Water	526,645	1%	521,697	14%	457,929
Total revenues	$2,178,178	(11)%	$2,434,124	8%	$2,259,271

	Year Ended December 31,					
	2012		2011		2010	
	Gross Profit	Gross Margin	Gross Profit	Gross Margin	Gross Profit	Gross Margin
Segment Gross Profit and Margin	(in thousands)		(in thousands)		(in thousands)	
Energy	$530,396	32.1%	$578,575	30.3%	$541,900	30.1%
Water	184,751	35.1%	167,883	32.2%	158,775	34.7%
Total gross profit and margin	$715,147	32.8%	$746,458	30.7%	$700,675	31.0%

	Year Ended December 31,					
	2012		2011		2010	
	Operating Income (Loss)	Operating Margin	Operating Income (Loss)	Operating Margin	Operating Income (Loss)	Operating Margin
Segment Operating Income (Loss) and Operating Margin	(in thousands)		(in thousands)		(in thousands)	
Energy	$135,369	8%	$(112,831)	(6)%	$184,163	10%

Water	59,210	11%	(303,772)	(58)%	43,611	10%
Corporate unallocated	(43,453)		(42,580)		(43,577)	
Total Company	$151,126	7%	$(459,183)	(19)%	$184,197	8%

Energy:

Revenues - 2012 vs. 2011

Electricity revenues for 2012 decreased by $215.1 million, or 17%, compared with 2011 revenues. The decrease was primarily driven by $207.6 million in lower OpenWay project revenue in North America, as four of our five largest OpenWay projects were substantially completed during 2012. This revenue decrease in North America was partially offset by $21.8 million of revenue

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increase as a result of the SmartSynch acquisition in May 2012. Lower prepayment meter shipments drove a decrease of $27.3 million in our Asia/Pacific region, which was partially offset by $23.0 million in higher revenue from increased product shipments and service in EMEA. The net translation effect of our operations in foreign currencies negatively impacted 2012 revenues by $34.4 million.

Gas revenues decreased by $45.8 million, or 7%, in 2012, compared to 2011, including $27.7 million for the impact of unfavorable exchange rates for our revenues denominated in foreign currencies. The decrease was driven by lower communication module shipments and lower service revenue, partially offset by increased gas meter shipments, particularly smart meters. The overall decrease is due to typical period-to-period fluctuations in timing of customer projects.

One customer represented 11% of the Energy operating segment revenues in 2012, and a different customer represented 11% of the Energy operating segment revenues in 2011.

Revenues - 2011 vs. 2010
Electricity revenues for 2011 increased by $53.5 million, or 5%, compared with 2010 revenues. Revenues for OpenWay electricity projects increased by $12.6 million, while revenues for prepayment meters in Asia/Pacific and Africa provided the balance of the increase.

Gas revenues increased by $57.5 million, or 9%, in 2011, compared to 2010, driven by increases in smart gas modules in North America and gas meters in Europe and Asia, partially offset by a $26.1 million decrease in OpenWay gas projects.

Two customers individually represented 14% and 10% of the Energy operating segment revenues in 2010.

Gross Margin - 2012 vs. 2011
Gross margin was 32.1% in 2012, compared with 30.3% in 2011. The improved margin was primarily driven by $23.8 million in lower warranty expense in 2012, as well as improved manufacturing efficiencies, global procurement, and the realization of the benefits of our restructuring activities.

Gross Margin - 2011 vs. 2010
Gross margin was 30.3% in 2011, compared with 30.1% in 2010. Increased revenues and margins for smart gas communication modules and non-OpenWay services were partially offset by higher warranty charges of $7.4 million in 2011.

Operating Expenses - 2012 vs. 2011
Energy operating expenses decreased by $296.4 million, or 43%, for 2012 when compared to 2011, primarily due to the goodwill impairment of $254.7 million recognized in 2011for the Electricity reporting unit and $48.9 million in lower restructuring expenses in 2012. Foreign exchange rates also favorably impacted operating expenses by $17.0 million. Sales and marketing and product development expenses increased over prior year by $31.6 million, primarily as the result of the development of new and enhanced products and in preparation for sales opportunities in developing markets. Operating expenses, consisting of sales and marketing, product development, general and administrative, and amortization of intangible assets, as a percentage of revenues, were 24% in 2012 and 20% in 2011.

Operating Expenses - 2011 vs. 2010
Energy operating expenses in 2011 included a goodwill impairment charge of $254.7 million associated with the Electricity reporting unit. Operating expenses included restructuring expenses of $51.9 million primarily associated with accrued severance and asset impairments. Operating expenses for sales and marketing, product development, general and administrative, and amortization of intangible assets increased $27.1 million, or 8%, in 2011, primarily

due to increased product development costs for new and enhanced products. This increase was partially offset by scheduled decreases in amortization of intangible assets and decreased bonus, profit sharing, and employee savings plan match expenses. Operating expenses, consisting of sales and marketing, product development, general and administrative, and amortization of intangible assets, as a percentage of revenues were 20% in 2011 and 2010.

Water:

Revenues - 2012 vs. 2011
Revenues increased $4.9 million, or 1%, in 2012, while the translation effect of a stronger U.S. dollar against most foreign currencies during 2012 negatively impacted revenues by 6%. All regions provided increases during 2012.

No single customer represented more than 10% of the Water operating segment's revenues in 2012, 2011, and 2010.

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Revenues - 2011 vs. 2010

Revenues increased $63.8 million, or 14%, in 2011, primarily driven by increased meter and smart module shipments in Europe. In addition, the net translation effect of foreign currencies into the U.S. dollar accounted for $15.0 million of the increase in revenues.

Gross Margin - 2012 vs. 2011

Water gross margin increased to 35.1% in 2012, compared with 32.2% in 2011, primarily driven by $12.4 million in lower warranty expense in 2012 and favorable product mix, which were partially offset by lower margin services for a large project in North America.

Gross Margin - 2011 vs. 2010

Water gross margin decreased to 32.2% in 2011, compared with 34.7% in 2010, primarily due to a combination of competitive pricing pressures and higher materials costs, including copper, as well as warranty charges of $12.6 million associated with a vendor supplied component.

Operating Expenses - 2012 vs. 2011

In 2012, Water operating expenses were $125.6 million compared to $471.7 million in 2011, including the favorable impact of foreign exchange rates of $7.6 million. Operating expenses in 2011 included a goodwill impairment charge of $330.1 million and $15.9 million in higher restructuring costs. Sales and marketing expenses in 2012 were $6.2 million higher than in 2011 due to investments in preparation for opportunities in developing markets. Product development expenses in 2012 were $4.5 million higher than in 2011 as the result of development of new and enhanced products to meet the demands of various markets. Operating expenses, consisting of sales and marketing, product development, general and administrative, and amortization of intangible assets, as a percentage of revenues, were 24% in 2012 and 2011.

Operating Expenses - 2011 vs. 2010

Water operating expenses in 2011 included a goodwill impairment charge of $330.1 million associated with the Water reporting unit. Operating expenses included restructuring expenses of $15.3 million primarily associated with accrued severance and asset impairments. Operating expenses for sales and marketing, product development, general and administrative, and amortization of intangible assets increased $11.1 million in 2011, compared with 2010. Operating expenses, consisting of sales and marketing, product development, general and administrative, and amortization of intangible assets, as a percentage of revenue were 24% in 2011, compared with 25% in 2010.

Corporate unallocated:

Operating expenses not directly associated with an operating segment are classified as “Corporate unallocated.” These expenses increased 2% to $43.5 million in 2012, compared with 2011, primarily due to acquisition related expenses for the SmartSynch acquisition, for management training and development costs in connection with the implementation of a new organizational structure, and for preliminary planning costs, prior to application development, for our global enterprise resource planning (ERP) software initiative. These increases were partially offset by lower corporate IT related and marketing spending. Corporate unallocated expenses decreased 2% to $42.6 million in 2011, compared with 2010, primarily due to decreased bonus and profit sharing expense.

Operating Expenses

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

	Year Ended December 31,					
	2012	% of	2011	% of	2010	% of

		Revenues		Revenues		Revenues
	(in thousands)		(in thousands)		(in thousands)	
Sales and marketing	$197,603	9%	$185,105	8%	$171,035	8%
Product development	178,653	8%	161,305	7%	139,166	6%
General and administrative	138,290	6%	142,908	6%	137,226	6%
Amortization of intangible assets	47,810	2%	63,394	3%	69,051	3%
Restructuring expense	1,665	—%	68,082	3%	—	—%
Goodwill impairment	—	—%	584,847	24%	—	—%
Total operating expenses	$564,021	26%	$1,205,641	50%	$516,478	23%

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2012 vs. 2011

Operating expenses decreased $641.6 million in 2012, compared with 2011. The 2011 operating expenses included $584.8 million of goodwill impairment charges associated with the Electricity and Water reporting units, as well as $68.1 million of restructuring expenses, which represented the majority of total expected expenses under our restructuring project initiated in 2011. Operating expenses for sales and marketing, product development, general and administrative, and amortization of intangible assets represented 26% of revenues in 2012, compared with 23% in 2011. Sales and marketing and product development expenses increased in 2012 compared with 2011, primarily due to increased product development costs for new and enhanced products and investments in targeted geographies in anticipation of sales opportunities. The increase was partially offset by favorable foreign currency translation effects and scheduled decreases in amortization of intangible assets.

2011 vs. 2010

Operating expenses in 2011 included a goodwill impairment of $584.8 million associated with two of our reporting units. Restructuring expenses were $68.1 million primarily associated with accrued severance and asset impairments. Operating expenses, consisting of sales and marketing, product development, general and administrative, and amortization of intangible assets, increased $36.2 million in 2011, compared with 2010, of which $13.1 million represented the net translation effect of foreign currencies to the U.S. dollar. Operating expenses, consisting of sales and marketing, product development, general and administrative, and amortization of intangible assets, as a percentage of revenue were 23% in 2011 and 2010. Higher costs related to product development for new and enhanced products, as well as higher marketing expense associated with the pursuit of smart grid opportunities were partially offset by a scheduled decrease in amortization of intangible assets.

Other Income (Expense)

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

	Year Ended December 31,		
	2012	2011	2010
	(in thousands)		
Interest income	$952	$862	$592
Interest expense	(8,518)	(31,079)	(49,412)
Amortization of prepaid debt fees	(1,597)	(5,715)	(5,492)
Other income (expense), net	(5,744)	(6,651)	(5,440)
Total other income (expense)	$(14,907)	$(42,583)	$(59,752)

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

Interest expense: Interest expense declined each period as a result of our principal balance of debt outstanding, as well as lower interest rates beginning in August 2011. Total debt was $417.5 million, $452.5 million, and $610.9 million at December 31, 2012, 2011, and 2010, respectively. In August 2011, we refinanced our credit facility. The interest rate on our 2011 credit facility was 1.47% at December 31, 2012. The weighted average interest rate on the borrowings under our 2007 credit facility at the time of refinancing (August 2011) was 4.75% (including the effect of an interest rate swap).

Amortization of prepaid debt fees: Amortization of prepaid debt fees in 2012 was lower than in 2011 by $4.1 million, primarily driven by the write-off of $2.4 million of prepaid debt fees in 2011 upon the refinancing of the 2007 credit facility. In addition, we incurred lower prepaid debt fees with the 2011 credit facility. Amortization of prepaid debt fees in 2011 was higher than 2010 due to the $2.4 million write-off of unamortized prepaid debt fees associated with our 2007 credit facility that was replaced with the 2011 credit facility. Amortization of prepaid debt fees fluctuate each year as debt is repaid early. As debt is repaid early, the related portion of unamortized prepaid debt fees is written-off. Refer to Item 8: “Financial Statements and Supplementary Data, Note 6: Debt” in this Annual Report on Form 10-K for additional details related to our long-term borrowings.

Other income (expense), net: Other expenses, net, consist primarily of unrealized and realized foreign currency gains and losses due to balances denominated in a currency other than the reporting entity's functional currency. Foreign currency losses, net of hedging, were $3.8 million in 2012, compared with net foreign currency losses of $4.7 million in 2011 and $3.1 million in 2010.

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Financial Condition

Cash Flow Information:

	Year Ended December 31,		
	2012	2011	2010
	(in thousands)		
Operating activities	$205,090	$252,358	$254,591
Investing activities	(125,445)	(78,741)	(56,274)
Financing activities	(77,528)	(209,453)	(148,637)
Effect of exchange rates on cash and cash equivalents	1,208	(555)	(2,096)
Increase (decrease) in cash and cash equivalents	$3,325	$(36,391)	$47,584

Cash and cash equivalents at December 31, 2012 was comparable to the prior year due to several offsetting factors, including lower net repayments on debt in 2012, compared with 2011, partially offset by increases in business acquisitions and repurchases of common stock and a decrease in cash provided by operating activities in 2012. Cash and cash equivalents was $133.1 million at December 31, 2011, compared with $169.5 million at December 31, 2010. The decrease in the cash and cash equivalents balance during 2011 was primarily the result of repayments of debt, the repurchase of common stock, and minor business acquisitions in 2011.

Operating activities
Cash provided by operating activities in 2012 was $47.3 million lower compared with 2011. This decline was primarily due to: (1) a decline in operating income, exclusive of non-cash items, such as goodwill impairment, depreciation and amortization, and non-cash restructuring expense, and (2) the net increase in working capital balances of $23.9 million in 2012, compared with a net decrease in working capital balances of $4.7 million in 2011. Cash provided by operating activities in 2011, inclusive of the impact of $12.8 million in cash payments made related to restructuring projects in 2011, was relatively constant when compared with 2010.

Investing activities
Net cash used in investing activities in 2012 was $46.7 million higher compared with 2011. The increase in investing activities during 2012 was the result of business acquisitions of $79.0 million, primarily related to the SmartSynch acquisition, as compared with business acquisitions of $20.1 million in 2011. The increase in cash used in business acquisitions in 2012 was partially offset by a decrease in acquisitions of property, plant, and equipment to $50.5 million in 2012, compared with $60.1 million in 2011. Refer to Item 8: "Financial Statements and Supplementary Data, Note 17: Business Combinations" for additional information regarding the acquisition of SmartSynch.

Net cash used in investing activities in 2011 was $22.5 million higher compared with 2010. Several business acquisitions totaling $20.1 million contributed to the increase in 2011, while property, plant, and equipment acquisitions in 2011 were comparable with 2010.

Financing activities
Net cash used in financing activities in 2012 was $131.9 million lower compared with 2011. During 2012, net repayments on borrowings were $35.0 million, compared with $178.1 million in 2011. On October 24, 2011, our Board of Directors authorized a twelve-month repurchase program of up to $100 million of our common stock, which, on September 13, 2012, was extended until February 15, 2013. During 2012, we repurchased $47.4 million of our common stock, compared with $29.4 million in 2011. We did not repurchase any stock from January 1, 2013 through February 15, 2013, when the stock repurchase program expired.

Net cash used in financing activities in 2011 was $60.8 million higher compared with 2010. During 2011, net repayments on borrowings were $178.1 million compared with $155.2 million in 2010. During 2011, we repurchased $29.4 million of our common stock, with no repurchases occurring in 2010. Refer to Item 8: “Financial Statements and Supplementary Data, Note 14: Shareholders' Equity” in this Annual Report on Form 10-K for additional details related to our share repurchase program.

Effect of exchange rates on cash and cash equivalents

Changes in exchange rates on the cash balances of currencies held in foreign denominations resulted in an increase of $1.2 million and decreases of $555,000 and $2.1 million in 2012, 2011, and 2010, respectively. Our primary foreign currency exposure relates to non-U.S. dollar denominated transactions in our international subsidiary operations, the most significant of which is the euro.

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Off-balance sheet arrangements:

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

Disclosures about contractual obligations and commitments:

The following table summarizes our known obligations to make future payments pursuant to certain contracts as of December 31, 2012, as well as an estimate of the timing in which these obligations are expected to be satisfied.

	Total	Less than 1 year	1-3 years	3-5 years	Beyond 5 years
	(in thousands)				
Credit Facilities[(1)]					
USD denominated term loan	$292,421	$22,829	$64,424	$205,168	$—
Multicurrency revolving line of credit	148,889	2,105	4,884	141,900	—
Operating lease obligations[(2)]	64,497	17,214	26,387	17,928	2,968
Purchase and service commitments[(3)]	184,826	180,515	3,929	382	—
Other long-term liabilities reflected on the balance sheet under generally accepted accounting principles[(4)]	104,252	—	49,960	23,338	30,954
Total	$794,885	$222,663	$149,584	$388,716	$33,922

(1) Borrowings are disclosed within Item 8: “Financial Statements and Supplementary Data, Note 6: Debt” included in this Annual Report on Form 10-K, with the addition of estimated interest expense but not including the amortization of prepaid debt fees.

(2) Operating lease obligations are disclosed in Item 8: “Financial Statements and Supplementary Data, Note 12: Commitments and Contingencies” included in this Annual Report on Form 10-K and do not include common area maintenance charges, real estate taxes, and insurance charges for which we are obligated.

(3) We enter into standard purchase orders in the ordinary course of business that typically obligate us to purchase materials and other items. Purchase orders can vary in terms, which include open-ended agreements that provide for estimated quantities over an extended shipment period, typically up to one year at an established unit cost. Our long-term executory purchase agreements that contain termination clauses have been classified as less than one year, as the commitments are the estimated amounts we would be required to pay at December 31, 2012 if the commitments were canceled.

(4) Other long-term liabilities consist of warranty obligations, estimated pension benefit payments, and other obligations. Estimated pension benefit payments include amounts from 2014-2022. Long-term unrecognized tax benefits totaling $23.9 million (net of pre-payments), which include accrued interest and penalties, are not included in the above contractual obligations and commitments table as we cannot reliably estimate the period of cash settlement with the respective taxing authorities. Additionally, because the amount and timing of the future cash outflows are uncertain, deferred revenue totaling $32.2, which includes deferred revenue related to extended warranty guarantees, is not included in the table. For further information on defined benefit pension plans, income taxes, and warranty obligations and deferred revenue for extended warranties, see Item 8: "Financial Statements and Supplementary Data," Notes 8, 11, and 12, respectively, included in this Annual Report on Form 10-K.

Liquidity and Capital Resources:

Our principal sources of liquidity are cash flows from operations, borrowings, and sales of common stock. Cash flows may fluctuate and are sensitive to many factors including changes in working capital and the timing and magnitude of capital expenditures and payments on debt. Working capital, which represents current assets less current liabilities, was $353.6 million at December 31, 2012, compared with $329.6 million at December 31, 2011.

Borrowings
In August 2011, we entered into an $800 million senior secured credit facility (the 2011 credit facility), which replaced the senior secured credit facility we entered into in 2007. The 2011 credit facility was increased to $960 million on April 2, 2012. The 2011 credit facility consists of a $300 million U.S. dollar term loan and a multicurrency revolving line of credit (the revolver) with a principal amount of up to $660 million, which was increased from $500 million on April 2, 2012. At December 31, 2012, $140 million was outstanding under the revolver, and $54.3 million was utilized by outstanding standby letters of credit, resulting in $465.7 million available for additional borrowings.

For further description of the term loan and the revolver under our 2011 credit facility, refer to Item 8: “Financial Statements and Supplementary Data, Note 6: Debt” included in this Annual Report on Form 10-K.

For a description of our letters of credit and performance bonds, and the amounts available for additional borrowings or letters of credit under our lines of credit, including the revolver that is part of our 2011 credit facility, refer to Item 8: “Financial Statements and Supplementary Data, Note 12: Commitments and Contingencies” included in this Annual Report on Form 10-K.

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

Total expected costs decreased by approximately $7.7 million during 2012 to $77.8 million as of December 31, 2012. This decrease was primarily the result of gains on the dispositions of fixed assets and a correction to the amount of goodwill allocated to one of our non-core businesses sold as part of the restructuring process. In addition, expected severance costs were reduced as the result of certain employees, in positions that were eliminated under the restructuring plan, filling vacant positions within the Company. For further details regarding the correction of the goodwill impairment, refer to Item 8: "Financial Statements and Supplementary Data, Note 5: Goodwill" included in this Annual Report on Form 10-K. A substantial portion of the total expected restructuring charges was recognized in the fourth quarter of 2011, and $17.7 million was accrued at December 31, 2012, of which $13.2 million is expected to be paid over the next 12 months. We have begun to realize benefits from our restructuring projects during 2012, and we expect full realization of the cost savings by the end of 2013 and into 2014. Certain projects are subject to a variety of labor and employment laws, rules, and regulations that could result in a delay in implementing projects at some locations. Real estate market conditions may impact the timing of our ability to sell some of the manufacturing facilities we have designated for closure and disposal. This may delay the completion of the restructuring projects beyond 2013. For further details regarding our restructuring activities, refer to Item 8: "Financial Statements and Supplementary Data, Note 13: Restructuring" included in this Annual Report on Form 10-K.

Income Tax
Our tax provision (benefit) as a percentage of income (loss) before tax typically differs from the U.S. federal statutory rate of 35%. Changes in our actual tax rate are subject to several factors, including fluctuations in operating results, new or revised tax legislation and accounting pronouncements, changes in the level of business in domestic and

foreign jurisdictions, tax credits (including research and development and foreign tax), state income taxes, adjustments to valuation allowances, and interest expense and penalties related to uncertain tax positions, among other items. Changes in tax laws and unanticipated tax liabilities could significantly impact our tax rate.

Our tax expense as a percentage of income before tax was 19.1% for 2012. Our actual tax rate was lower than the 35% U.S. federal statutory tax rate primarily due to: (1) earnings of our subsidiaries outside of the United States in jurisdictions where our statutory tax rate is lower than in the United States; (2) the benefit of certain interest expense deductions; (3) a benefit related to the release of reserves for uncertain tax positions; and (4) benefits of certain acquisition related elections for tax purposes.

Our tax expense as a percentage of loss before tax was (0.9%) for 2011. Our actual tax rate was lower than the 35% U.S. federal statutory tax rate primarily due to: (1) the impact of the goodwill impairment, which was not deductible; (2) earnings of our subsidiaries outside of the United States in jurisdictions where our statutory tax rate is lower than in the United States; (3) the

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benefit of certain interest expense deductions; (4) a benefit related to the settlement of foreign tax litigation; and (5) benefits of certain acquisition related elections for tax purposes.

Our tax expense as a percentage of income before tax was 12.8% for 2010. Our actual tax rate was lower than the 35% U.S. federal statutory tax rate primarily due to: (1) earnings of our subsidiaries outside of the United States in jurisdictions where our statutory tax rate is lower than in the United States; (2) the benefit of certain interest expense deductions; and (3) the de-recognition of a reserve for uncertain tax positions due to a change in the method of depreciation for certain foreign subsidiaries

Our deferred tax assets consist primarily of tax losses and temporary differences related to depreciation, amortization and accrued expenses.

Our deferred tax assets at December 31, 2012 do not include the tax effect on $55.2 million of excess tax benefits from employee stock plan exercises. Common stock will be increased by $21.0 million when such excess tax benefits reduce cash taxes payable.

Our cash income tax payments for 2012, 2011, and 2010 were as follows:

	Year Ended December 31,		
	2012	2011	2010
	(in thousands)		
U.S. federal taxes paid	$15,500	$5,900	$4,060
State income taxes paid	2,831	2,450	505
Foreign and local income taxes paid	22,468	19,779	25,577
Total income taxes paid	$40,799	$28,129	$30,142

Based on current projections, we expect to pay, net of refunds, approximately $400,000 in state taxes and $28.9 million in foreign and local income taxes in 2013. Currently, we do not expect to pay any U.S. federal taxes in 2013.

As of December 31, 2012, there was $41.1 million of cash and short-term investments held by certain foreign subsidiaries that could be repatriated to fund U.S. operations, and additional tax costs may be required. Tax is one of many factors that we consider in the management of global cash. Included in the determination of the tax costs in repatriating foreign cash into the United States are the amount of earnings and profits in a particular jurisdiction, withholding taxes that would be imposed, and available foreign tax credits. Accordingly, the amount of taxes that we would need to accrue and pay to repatriate foreign cash could vary significantly.

The American Taxpayer Relief Act of 2012 (the "Act") was signed into law on January 2, 2013 and extended several business tax provisions including: (1) the active financing income and controlled foreign corporation look-through exceptions to certain foreign income; and (2) the research and experimentation credit. The tax effects of the Act will be recognized in the first quarter of 2013.

Other Liquidity Considerations

For a description of our funded and unfunded non-U.S. defined benefit pension plans and our expected 2013 contributions, refer to Item 8: “Financial Statements and Supplementary Data, Note 8: Defined Benefit Pension Plans” included in this Annual Report on Form 10-K.

At December 31, 2012, we have accrued $22.1 million of bonus and profit sharing plans expense for the achievement of annual financial and nonfinancial targets, compared with $26.0 million at December 31, 2011. These awards will be paid in cash during the first quarter of 2013.

The Company conducts business in Italy, Spain, and Portugal, which have been experiencing significant financial stress. As of December 31, 2012, we had trade receivables in these countries of approximately 1% of consolidated total assets, compared with approximately 2% as of December 31, 2011. As of December 31, 2012 and 2011, we did not have any marketable investments in corporate or sovereign government debt securities in these countries.

We expect to grow through a combination of internal new product development, licensing technology from and to others, distribution agreements, partnership arrangements, and acquisitions of technology or other companies. We expect these activities to be funded with existing cash, cash flow from operations, borrowings, and the sale of common stock or other securities. We believe existing sources of liquidity will be sufficient to fund our existing operations and obligations for the next 12 months and into the foreseeable future, but offer no assurances. Our liquidity could be affected by the stability of the energy and water industries, competitive pressures, changes in estimated liabilities for product warranties and/or litigation, future business combinations, capital market fluctuations, international risks, and other factors described under “Risk Factors” included in this Annual Report on Form 10-K.

Contingencies

Refer to Item 8: “Financial Statements and Supplementary Data, Note 12: Commitments and Contingencies” included in this Annual Report on Form 10-K.

Critical Accounting Estimates

Revenue Recognition

The majority of our revenue arrangements involve multiple deliverables, which require us to determine the fair value of each deliverable and then allocate the total arrangement consideration among the separate deliverables based on the relative fair value percentages. Revenues for each deliverable are then recognized based on the type of deliverable, such as 1) when the products are shipped, 2) services are delivered, 3) percentage-of-completion when implementation services are essential to other deliverables in the arrangement, 4) upon receipt of customer acceptance, or 5) transfer of title and risk of loss. A majority of our revenue is recognized when products are shipped to or received by a customer or when services are provided.

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

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

Certain of our revenue arrangements include an extended or noncustomary warranty provision that covers all or a portion of a customer’s replacement or repair costs beyond the standard or customary warranty period. Whether or not the extended warranty is separately priced in the arrangement, a portion of the arrangement’s total consideration is allocated to this extended warranty deliverable. This revenue is deferred and recognized over the extended warranty coverage period. Extended or noncustomary warranties do not represent a significant portion of our revenue.

We allocate consideration to each deliverable in an arrangement based on its relative selling price. We determine selling price using vendor specific objective evidence (VSOE), if it exists, otherwise third-party evidence (TPE). If neither VSOE nor TPE of selling price exists for a unit of accounting, we use estimated selling price (ESP).

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

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

Warranty

We offer standard warranties on our hardware products and large application software products. We accrue the estimated cost of new product warranties based on historical and projected product performance trends and costs during the warranty period. Testing of new products in the development stage helps identify and correct potential warranty issues prior to manufacturing. Continuous quality control efforts during manufacturing reduce our exposure to warranty claims. If our quality control efforts fail to detect a

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

Restructuring and Asset Impairments

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

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

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

Income Taxes

We estimate income tax expense in each of the taxing jurisdictions in which we operate. Changes in our actual tax rate are subject to several factors, including fluctuations in operating results, new or revised tax legislation and accounting pronouncements, changes in the level of business in domestic and foreign jurisdictions, tax credits (including research and development and foreign tax), state income taxes, adjustments to valuation allowances, and interest expense and penalties related to uncertain tax positions, among other items. Changes in tax laws and unanticipated tax liabilities could significantly impact our tax rate.

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

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

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

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

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

Goodwill is assigned to our reporting units based on the expected benefit from the synergies arising from each business combination, determined by using certain financial metrics, including the forecasted discounted cash flows associated with each reporting unit. Prior to 2012, we had four reporting units: Itron North America (INA), Itron International (INL) Electricity, INL Gas, and INL Water. Effective January 1, 2012, our three reporting units are Electricity, Gas, and Water. Our Energy operating segment comprises the Electricity and Gas reporting units, while our Water operating segment comprises the Water reporting unit. In the first quarter of 2012, we reallocated the goodwill from our former INA reporting unit to the three new reporting units based on the relative fair values of the electricity, gas, and water product lines within INA on January 1, 2012. We also reassigned the goodwill from our former INL Electricity, INL Gas, and INL Water reporting units to the new reporting units, Electricity, Gas, and Water, respectively.

We test goodwill for impairment each year as of October 1, or more frequently should a significant impairment indicator occur. The impairment test for goodwill involves comparing the fair value of the reporting units to their carrying amounts. If the carrying amount of a reporting unit exceeds its fair value, a second step is required to measure for a goodwill impairment loss. This step revalues all assets and liabilities of the reporting unit to their current fair values and then compares the implied fair value of the reporting unit's goodwill to the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

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

As a result of the significant decline in the price of our shares of common stock at the end of September 2011, our aggregate market value was significantly lower than the aggregate carrying value of our net assets. As a result, we performed an interim impairment test of our goodwill as of September 30, 2011, which resulted in an impairment charge. The goodwill impairment did not impact the debt covenants compliance under the Company's existing credit facility.

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

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

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Based on our most recent annual goodwill impairment test as of October 1, 2012, the percentage by which the estimated fair value of the reporting units exceeded their carrying value and amount of goodwill allocated to each of these reporting units were as follows:

Reporting Unit	October 1, 2012 Goodwill	Fair Value Exceeded Carrying Value	
	(in thousands)		
Energy - Electricity	$221,119	19	%
Energy - Gas	382,563	66	%
Water	83,750	317	%

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

Derivative Instruments
All derivative instruments, whether designated in hedging relationships or not, are recorded on the Consolidated Balance Sheets at fair value as either assets or liabilities. The components and fair values of our derivative instruments are determined using the fair value measurements of significant other observable inputs (also known as “Level 2”), as defined by U.S. generally accepted accounting principles. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments is in a asset position and the effect of our own nonperformance risk when the net fair value of our derivative instruments is in a liability position. Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in non-active markets, and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means (inputs may include yield curves, volatility measures, credit risks, and default rates). Derivatives are not used for trading or speculative purposes. Our derivatives are with credit worthy multinational commercial banks, with whom we have master netting agreements; however, our derivative positions are not disclosed on a net basis. There are no credit risk related contingent features within our derivative instruments.

Defined Benefit Pension Plans
We sponsor both funded and unfunded defined benefit pension plans for certain international employees, primarily in Germany, France, Italy, Indonesia, and Spain. We recognize a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation. We also recognize the funded status of our defined benefit pension plans on our Consolidated Balance Sheets and recognize as a component of other comprehensive income (loss) (OCI), net of tax, the actuarial gains or losses and prior service costs or credits, if any, that arise during the period but are not recognized as components of net periodic benefit cost.

Several economic assumptions and actuarial data are used in calculating the expense and obligations related to these plans. The assumptions are updated annually at December 31 and include the discount rate, the expected remaining service life, the expected rate of return on plan assets, and rate of future compensation increase. The discount rate is a significant assumption used to value our pension benefit obligation. We determine a discount rate for our plans based on the estimated duration of each plan’s liabilities. For our euro denominated defined benefit pension plans, which represent 94% of our benefit obligation, we use three discount rates, with consideration of the duration of the plans, using a hypothetical yield curve developed from euro-denominated AA-rated corporate bond issues, partially weighted for market value, with minimum amounts outstanding of €250 million for bonds with less than 10 years to maturity and €50 million for bonds with 10 or more years to maturity, and excluding the highest and lowest yielding

10% of bonds within each maturity group. The discount rates used, depending on the duration of the plans, were 2.75%, 3.25% and 3.50%, respectively. The weighted average discount rate used to measure the projected benefit obligation for all of the plans at December 31, 2012 was 3.36%. A change of 25 basis points in the discount rate would change our pension benefit obligation by approximately $4.0 million. The financial and actuarial assumptions used at December 31, 2012 may differ materially from actual results due to changing market and economic conditions and other factors. These differences could result in a significant change in the amount of pension expense recorded in future periods. Gains and losses resulting from changes in actuarial assumptions, including the discount rate, are recognized in OCI in the period in which they occur.

Our general funding policy for these qualified pension plans is to contribute amounts at least sufficient to satisfy funding standards of the respective countries for each plan. Refer to Item 8: "Financial Statements and Supplementary Data, Note 8: Defined Benefit Pension Plans" included in this Annual Report on Form 10-K for our expected contributions for 2013.

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Contingencies

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

Stock-Based Compensation

We measure and recognize compensation expense for all stock-based awards made to employees and directors, including awards of stock options, stock sold pursuant to our Employee Stock Purchase Plan (ESPP), and the issuance of restricted stock units and unrestricted stock awards, based on estimated fair values. The fair value of stock options is estimated at the date of grant using the Black-Scholes option-pricing model, which includes assumptions for the dividend yield, expected volatility, risk-free interest rate, and expected life. In valuing our stock options, significant judgment is required in determining the expected volatility of our common stock and the expected life that individuals will hold their stock options prior to exercising. Expected volatility is based on the historical and implied volatility of our own common stock. The expected life of stock option grants is derived from the historical actual term of option grants and an estimate of future exercises during the remaining contractual period of the option. While volatility and estimated life are assumptions that do not bear the risk of change subsequent to the grant date of stock options, these assumptions may be difficult to measure as they represent future expectations based on historical experience. Further, our expected volatility and expected life may change in the future, which could substantially change the grant-date fair value of future awards of stock options and, ultimately, the expense we record. For ESPP awards, the fair value is the difference between the market close price of our common stock on the date of purchase and the discounted purchase price. For restricted stock units and unrestricted stock awards, the fair value is the market close price of our common stock on the date of grant. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results and future estimates may differ substantially from our current estimates. We expense stock-based compensation at the date of grant for unrestricted stock awards. For awards with only a service condition, we expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the requisite service period for the entire award. For awards with both performance and service conditions, we expense the stock-based compensation, adjusted for estimated forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the award. Excess tax benefits are credited to common stock when the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the Consolidated Statements of Cash Flows.

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ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk

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

The table below provides information about our financial instruments that are sensitive to changes in interest rates and the scheduled minimum repayment of principal and estimated cash interest payments over the remaining lives of our debt at December 31, 2012. Weighted average variable rates in the table are based on implied forward rates in the Reuters U.S. dollar yield curve as of December 31, 2012 and our estimated leverage ratio, which determines our additional interest rate margin at December 31, 2012.

	2013	2014	2015	2016	2017	Total	Fair Value
	(in thousands)						
Variable Rate Debt							
Principal: U.S. dollar term loan	$18,750	$26,250	$30,000	$202,500	$—	$277,500	$275,365
Average interest rate	1.48 %	1.60 %	1.83 %	2.21 %	— %		
Principal: Multicurrency revolving line of credit	$—	$—	$—	$140,000	$—	$140,000	$138,751
Average interest rate	1.48 %	1.60 %	1.83 %	2.21 %	— %		
Interest rate swap on LIBOR based debt							
Average interest rate (pay)	1.00 %	1.00 %	1.00 %	1.00 %	— %		
Average interest rate (receive)	0.25 %	0.35 %	0.58 %				