ITRON INC /WA/
Form 10-Q
August 04, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2010

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 000-22418

ITRON, INC.

(Exact name of registrant as specified in its charter)

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

2111 N Molter Road, Liberty Lake, Washington 99019

(509) 924-9900

(Address and telephone number of registrant s principal executive offices)

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

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

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

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

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

As of June 30, 2010 there were outstanding 40,374,888 shares of the registrant s common stock, no par value, which is the only class of common stock of the registrant.

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Itron, Inc.

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements (Unaudited)

ITRON, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands, except per share data)			
Revenues	$ 569,460	$ 413,748	$ 1,068,740	$ 802,266
Cost of revenues	393,136	280,639	733,521	539,573
Gross profit	176,324	133,109	335,219	262,693
Operating expenses				
Sales and marketing	40,974	37,925	82,511	74,900
Product development	33,022	30,809	66,062	61,967
General and administrative	33,285	28,467	66,342	57,491
Amortization of intangible assets	16,766	24,189	34,577	47,667
Total operating expenses	124,047	121,390	249,492	242,025
Operating income	52,277	11,719	85,727	20,668
Other income (expense)				
Interest income	111	481	278	1,016
Interest expense	(13,965)	(16,399)	(28,888)	(33,244)
Loss on extinguishment of debt, net	-	-	-	(10,340)
Other income (expense), net	(425)	(2,877)	(1,017)	(4,911)
Total other income (expense)	(14,279)	(18,795)	(29,627)	(47,479)
Income (loss) before income taxes	37,998	(7,076)	56,100	(26,811)
Income tax (provision) benefit	(11,098)	22,365	(2,413)	22,371
Net income (loss)	$ 26,900	$ 15,289	$ 53,687	$ (4,440)
Earnings (loss) per common share-Basic	$ 0.67	$ 0.40	$ 1.33	$ (0.12)
Earnings (loss) per common share-Diluted	$ 0.65	$ 0.40	$ 1.31	$ (0.12)
Weighted average common shares outstanding-Basic	40,329	37,776	40,261	36,968
Weighted average common shares outstanding-Diluted	41,161	38,130	41,011	36,968

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

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ITRON, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 137,371	$ 121,893
Accounts receivable, net	366,476	337,948
Inventories	201,678	170,084
Deferred tax assets current, net	20,833	20,762
Other current assets	65,336	75,229
Total current assets	791,694	725,916
Property, plant, and equipment, net	289,409	318,217
Prepaid debt fees	7,109	8,628
Deferred tax assets noncurrent, net	67,684	89,932
Other noncurrent assets	15,612	18,117
Intangible assets, net	309,030	388,212
Goodwill	1,146,082	1,305,599
Total assets	$ 2,626,620	$ 2,854,621
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 235,441	$ 219,255
Other current liabilities	59,677	64,583
Wages and benefits payable	85,386	71,592
Taxes payable	18,097	14,377
Current portion of long-term debt	10,182	10,871
Current portion of warranty	26,250	20,941
Unearned revenue	37,987	40,140
Deferred tax liabilities current, net	1,625	1,625
Total current liabilities	474,645	443,384
Long-term debt	663,159	770,893
Warranty	22,953	12,932
Pension plan benefits	54,953	63,040
Deferred tax liabilities noncurrent, net	60,017	80,695
Other noncurrent obligations	67,908	83,163
Total liabilities	1,343,635	1,454,107
Commitments and contingencies		
Shareholders equity		
Preferred stock	-	-
Common stock	1,315,067	1,299,134
Accumulated other comprehensive income (loss), net	(116,019)	71,130

Retained earnings		83,937		30,250
Total shareholders equity		1,282,985		1,400,514
Total liabilities and shareholders equity	$	2,626,620	$	2,854,621

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

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ITRON, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended June 30,	
	2010	2009
	(in thousands)	
Operating activities		
Net income (loss)	$ 53,687	$ (4,440)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	65,071	74,407
Stock-based compensation	9,121	9,279
Amortization of prepaid debt fees	2,762	2,272
Amortization of convertible debt discount	4,957	4,895
Loss on extinguishment of debt, net	-	9,960
Deferred taxes, net	(7,159)	(35,000)
Other adjustments, net	3,306	(465)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(52,332)	9,940
Inventories	(40,930)	(1,575)
Accounts payables, other current liabilities, and taxes payable	42,463	(4,054)
Wages and benefits payable	19,648	(9,004)
Unearned revenue	(1,205)	12,719
Warranty	14,034	(4,190)
Other operating, net	3,663	2,609
Net cash provided by operating activities	117,086	67,353
Investing activities		
Acquisitions of property, plant, and equipment	(27,716)	(27,804)
Business acquisitions & contingent consideration, net of cash equivalents acquired	-	(1,317)
Other investing, net	4,495	3,973
Net cash used in investing activities	(23,221)	(25,148)
Financing activities		
Payments on debt	(73,881)	(70,241)
Issuance of common stock	6,812	162,153
Prepaid debt fees	(1,340)	(3,992)
Other financing, net	(897)	(587)
Net cash (used in) provided by financing activities	(69,306)	87,333
Effect of foreign exchange rate changes on cash and cash equivalents	(9,081)	2,200
Increase in cash and cash equivalents	15,478	131,738
Cash and cash equivalents at beginning of period	121,893	144,390
Cash and cash equivalents at end of period	$ 137,371	$ 276,128
Non-cash transactions:		

Fixed assets purchased but not yet paid, net	$	(3,491)	$	5,149
Exchange of debt (face value) for common stock		-		120,984
Contingent consideration payable for previous acquisitions		-		2,000
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Income taxes	$	9,355	$	5,926
Interest, net of amounts capitalized		21,178		31,932

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

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ITRON, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(UNAUDITED)

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

Note 1: Summary of Significant Accounting Policies

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

Financial Statement Preparation

The condensed consolidated financial statements presented in this Quarterly Report on Form 10-Q are unaudited and reflect entries necessary for the fair presentation of the Consolidated Statements of Operations for the three and six months ended June 30, 2010 and 2009, the Consolidated Balance Sheets as of June 30, 2010 and December 31, 2009, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009 of Itron, Inc. and its subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature, except as disclosed.

Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim results. These condensed consolidated financial statements should be read in conjunction with the 2009 audited financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the SEC on February 25, 2010. The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

Basis of Consolidation

We consolidate all entities in which we have a greater than 50% ownership interest. We also consolidate entities in which we have a 50% or less investment and over which we have control. We use the equity method of accounting for entities in which we have a 50% or less investment and exercise significant influence. Entities in which we have less than a 20% investment and where we do not exercise significant influence are accounted for under the cost method. We consider for consolidation any variable interest entity of which we are the primary beneficiary. At June 30, 2010, our investments in variable interest entities and noncontrolling interests were not material. Intercompany transactions and balances have been eliminated upon consolidation.

Cash and Cash Equivalents

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

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, which are primarily interest rate swaps, are determined using the fair value measurements of significant other observable inputs (Level 2), as defined by GAAP.

The net fair value of our derivative instruments may switch between a net asset and a net liability depending on market circumstances at the end of the period. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments are in a net asset position and the effect of our own nonperformance risk when the net fair value of our derivative instruments are in a net liability position. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded as a component of other comprehensive income (loss) (OCI) and are recognized in earnings when the hedged item affects earnings. For our hedge of a net investment, the effective portion of any unrealized gain or loss from the foreign currency revaluation of the hedging instrument is reported in OCI as a net unrealized gain or loss on derivative instruments. Ineffective portions of fair value changes or the changes in fair value of derivative instruments that do not qualify for hedging activities are recognized in other income (expense) in the Consolidated Statements of Operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Consolidated Statements of Cash Flows.

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Derivatives are not used for trading or speculative purposes. Our derivatives are with major international financial institutions, with whom we have master netting agreements; however, our derivative positions are not disclosed on a net basis. There are no credit-risk-related contingent features within our derivative instruments. Refer to Note 7 and Note 12 for further disclosures of our derivative instruments and their impact on OCI.

Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

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

Property, Plant, and Equipment

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

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset or asset group may not be recoverable. We have had no significant impairments of long-lived assets. Assets held for sale are classified within other current assets in the Consolidated Balance Sheets, are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. We had no assets held for sale at June 30, 2010 or December 31, 2009.

Prepaid Debt Fees

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

Business Combinations

On the date of acquisition, the assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree are recorded at their fair values. The acquiree results of operations are also included as of the date of acquisition in the consolidated results. Intangible assets that arise from contractual/legal rights, or are capable of being separated, as well as in-process research and development (IPR&D), are measured and recorded at fair value. If practicable, assets acquired and liabilities assumed arising from contingencies are measured and recorded at fair value. If not practicable, such assets and liabilities are measured and recorded when it is probable that a gain or loss has occurred and the amount can be reasonably estimated. We capitalize any future IPR&D as an intangible asset and amortize the balance over its estimated useful life. The residual balance of the purchase price, after fair value allocations to all identified assets and liabilities, represents goodwill. Acquisition-related costs are expensed as incurred. Restructuring costs are generally expensed in periods subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period are recognized as a component of provision for income taxes.

Goodwill and Intangible Assets

Goodwill and intangible assets have resulted from our acquisitions. We use estimates in determining and assigning the fair value of goodwill and intangible assets, including estimates of useful lives of intangible assets, the amount and timing of related future cash flows, and fair values of the related operations. Our intangible assets have finite lives, are amortized over their estimated useful lives based on estimated discounted cash flows, and are tested for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

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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. Goodwill is tested for impairment as of October 1 of each year, or more frequently if a significant impairment indicator occurs. 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 our reporting units.

Warranty

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

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. Changes in these factors and related estimates could materially affect our financial position and results of operations.

Bonus and Profit Sharing

We have various employee bonus and profit sharing plans, which provide award amounts for the achievement of annual financial and nonfinancial targets. If management determines it probable that the targets will be achieved and the amounts can be reasonably estimated, a compensation accrual is recorded based on the proportional achievement of the financial and nonfinancial targets. Although we monitor and accrue expenses quarterly based on our progress toward the achievement of the annual targets, the actual results at the end of the year may require awards that are significantly greater or less than the estimates made in earlier quarters.

Defined Benefit Pension Plans

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

Revenue Recognition

Revenues consist primarily of hardware sales, software license fees, software implementation, project management services, installation, consulting, and post-sale maintenance support.

On January 1, 2010, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Tax Force)* and ASU 2009-14, *Software (Topic 985), Certain Revenue Arrangements That Include Software Elements (a consensus of the FASB Emerging Issues Task Force)* on a prospective basis for new arrangements and arrangements that are materially modified. This new guidance did not have a material impact on our financial statements for the three and six months ended June 30, 2010, as we already had the ability to divide the deliverables within our revenue arrangements into separate units of accounting. Further, there would have been no change to the amount of revenue recognized in the year ended December 31, 2009 if arrangements prior to the adoption of ASU 2009-13 and ASU 2009-14 had been subject to the measurement requirements of this new guidance.

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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.

For arrangements entered into or materially modified after January 1, 2010, if we are unable to establish selling price using VSOE or TPE, we will 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 plan to analyze the selling prices used in our allocation of arrangement consideration on an annual basis. Selling prices will be 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.

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

Revenues are recognized when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. Hardware revenues are generally recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions.

For multiple element software arrangements that do not include hardware, revenue recognition is dependent upon the availability of VSOE for fair value for each of the elements. The lack of VSOE, or the existence of extended payment terms or other inherent risks, may affect the timing of revenue recognition for software arrangements.

We primarily enter into two types of multiple deliverable arrangements, which may include any combination of hardware and associated software and services.

Arrangements that do not include the deployment of our OpenWay® technology are recognized as follows:

- Revenue from hardware shipments is recognized upon delivery once title and risk of loss pass to the customer.

- If implementation services are essential to the functionality of the associated software, software and implementation revenues are recognized using either the percentage-of-completion methodology of contract accounting if project costs can be estimated, or the completed contract methodology if project costs cannot be reliably estimated.

Arrangements to deploy our OpenWay technology are recognized as follows:

- Revenue from hardware shipments is recognized upon delivery once title and risk of loss pass to the customer.

Revenue from associated software and services is recognized using the units-of-delivery method of contract accounting. This methodology often results in the deferral of costs and revenues as professional services and software implementation typically commence prior to deployment of hardware.

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In all cases, hardware and software post-sale maintenance support fees are recognized ratably over the life of the related service contract.

Shipping and handling costs and incidental expenses billed to customers are recorded as revenue, with the associated cost charged to cost of revenues. We record sales, use, and value added taxes billed to our customers on a net basis.

Unearned revenue is recorded when a customer pays for products or services, but the criteria for revenue recognition have not been met as of the balance sheet date. Unearned revenues of $43.5 million and $45.4 million at June 30, 2010 and December 31, 2009 related primarily to professional services and software associated with our OpenWay contracts, extended warranty, and prepaid post contract support. Deferred cost is recorded for products or services for which ownership (typically defined as title and risk of loss) has transferred to the customer, but the criteria for revenue recognition have not been met as of the balance sheet date. Deferred costs were $12.7 million and $19.7 million at June 30, 2010 and December 31, 2009.

Product and Software Development Costs

Product and software development costs primarily include employee compensation and third party contracting fees. For software we develop to be marketed or sold, we capitalize development costs after technological feasibility is established. Due to the relatively short period of time between technological feasibility and the completion of product and software development, and the immaterial nature of these costs, we generally do not capitalize product and software development expenses.

Stock-Based Compensation

We measure and recognize compensation expense for all stock-based awards made to employees and directors, including stock options, stock sold pursuant to our Amended and Restated 2002 Employee Stock Purchase Plan (ESPP), and the issuance of restricted and unrestricted stock awards and units, based on estimated fair values. The fair values of stock options and ESPP awards are estimated at the date of grant using the Black-Scholes option-pricing model, which includes assumptions for the dividend yield, expected volatility, risk-free interest rate, and expected life. For restricted and unrestricted stock awards and units, the fair value is the market close price of our common stock on the date of grant. We expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the vesting requirement period. Excess tax benefits are credited to common stock when the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the Consolidated Statements of Cash Flows.

Loss on Extinguishment of Debt, Net

Upon partial or full redemption of our borrowings, we recognize a gain or loss for the difference between the cash paid and the net carrying amount of the debt redeemed. Included in the net carrying amount is any unamortized premium or discount from the original issuance of the debt. Due to the particular characteristics of our convertible notes, upon conversion or derecognition of our convertible notes, we recognize a gain or loss for the difference between the fair value of the consideration transferred to the holder that is allocated to the liability component, which is equal to the fair value of the liability component immediately prior to extinguishment, and the net carrying amount of the liability component (including any unamortized discount and debt issuance costs). In the case of an induced conversion, a loss is recognized for the amount of the fair value of the securities or other consideration transferred to the holder in excess of fair value of the consideration issuable in accordance with the original conversion terms of the debt.

Income Taxes

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

We compute our interim income tax provision through the use of an estimated annual effective tax rate (ETR) applied to year-to-date operating results and specific events that are discretely recognized as they occur. In determining the estimated annual ETR, we analyze various factors, including projections of our annual earnings, taxing jurisdictions in which the

earnings will be generated, the impact of state and local income taxes, our ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments, are reflected in the period in which they occur as an addition to, or reduction from, the income tax provision, rather than included in the estimated annual ETR.

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

Foreign Exchange

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

Fair Value Measurements

For assets and liabilities measured at fair value, the GAAP fair value hierarchy prioritizes the inputs used in different valuation methodologies, assigning the highest priority to unadjusted quoted prices for identical assets and liabilities in actively traded markets (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in non-active markets; and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means (inputs may include yield curves, volatility, credit risks, and default rates). We hold no assets or liabilities measured using Level 1 fair value inputs.

Use of Estimates

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

New Accounting Pronouncements

In April 2010, the FASB issued ASU 2010-13, *Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Primarily Trades*, to eliminate disparity in practice. ASU 2010-13 clarifies that differences between currencies of the underlying equity securities of the share-based payment award and the functional currency of the employer entity or the employee s payroll currency should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. This pronouncement will be effective on January 1, 2011 and will not have an impact on our consolidated financial statements as we treat this type of share-based payment award as equity.

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Note 2: Earnings Per Share and Capital Structure

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands, except per share data)			
Net income (loss) available to common shareholders	$ 26,900	$ 15,289	$ 53,687	$ (4,440)
Weighted average common shares outstanding-Basic	40,329	37,776	40,261	36,968
Dilutive effect of convertible notes	283	354	206	-
Dilutive effect of stock-based awards	549	-	544	-
Weighted average common shares outstanding-Diluted	41,161	38,130	41,011	36,968
Earnings (loss) per common share-Basic	$ 0.67	$ 0.40	$ 1.33	$ (0.12)
Earnings (loss) per common share-Diluted	$ 0.65	$ 0.40	$ 1.31	$ (0.12)

Stock-based Awards

For stock-based awards, the dilutive effect is calculated using the treasury stock method. Under this method, the dilutive effect is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise, future compensation cost associated with the stock award, and the amount of excess tax benefits, if any. Approximately 374,000 and 671,000 stock-based awards were excluded from the calculation of diluted EPS for the three months ended June 30, 2010 and 2009, and approximately 419,000 and 1.0 million stock-based awards were excluded from the calculation of diluted EPS for the six months ended June 30, 2010 and 2009 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Convertible Notes

We are required, pursuant to the indenture for the convertible notes, to settle the principal amount of the convertible notes in cash and may elect to settle the remaining conversion obligation (stock price in excess of conversion price) in cash, shares, or a combination. We include in the EPS calculation the amount of shares it would take to satisfy the conversion obligation, assuming that all of the convertible notes are converted. The average closing prices of our common stock for the three and six months ended June 30, 2010 and 2009 were used as the basis for determining the dilutive effect on EPS. The average price of our common stock for the three and six months ended June 30, 2010 exceeded the conversion price of $65.16 and, therefore, approximately 283,000 and 206,000 shares have been included in the diluted EPS calculation for these respective periods. The average price of our common stock for the three and six months ended June 30, 2009 did not exceed the conversion price of $65.16 and, therefore, did not have an effect on diluted shares outstanding.

Preferred Stock

We have authorized the issuance of 10 million shares of preferred stock with no par value. In the event of a liquidation, dissolution, or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of any outstanding preferred stock will be entitled to be paid a preferential amount per share to be determined by the Board of Directors prior to any payment to holders of common stock. Shares of preferred stock may be converted into common stock based on terms, conditions, rates, and subject to such adjustments as set by the Board of Directors. There was no preferred stock sold or outstanding at June 30, 2010 and December 31, 2009.

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Note 3: Certain Balance Sheet Components

Accounts receivable, net

	At June 30, 2010	At December 31, 2009
	(in thousands)	
Trade receivables (net of allowance of $6,298 and $6,339)	$ 334,498	$ 319,237
Unbilled revenue	31,978	18,711
Total accounts receivable, net	$ 366,476	$ 337,948

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

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
	(in thousands)			
Beginning balance	$ 5,870	$ 5,213	$ 6,339	$ 5,954
Provision for doubtful accounts, net	742	2,008	662	1,890
Accounts written off	(43)	(339)	(173)	(636)
Effects of change in exchange rates	(271)	389	(530)	63
Ending balance, June 30	$ 6,298	$ 7,271	$ 6,298	$ 7,271

Inventories

	At June 30, 2010	At December 31, 2009
	(in thousands)	
Materials	$ 105,496	$ 85,358
Work in process	19,322	17,668
Finished goods	76,860	67,058
Total inventories	$ 201,678	$ 170,084

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

Consigned inventory is held at third-party locations; however, we retain title to the inventory until purchased by the third-party. Consigned inventory, consisting of raw materials and finished goods, was $9.7 million and $10.6 million at June 30, 2010 and December 31, 2009, respectively.

Property, plant, and equipment, net

	At June 30,	At December 31,
	2010	2009
	(in thousands)	
Machinery and equipment	$ 244,891	$ 243,652
Computers and purchased software	58,744	66,787
Buildings, furniture, and improvements	136,669	144,639
Land	34,505	37,738
Construction in progress, including purchased equipment	18,104	22,009
Total cost	492,913	514,825
Accumulated depreciation	(203,504)	(196,608)
Property, plant, and equipment, net	$ 289,409	$ 318,217

Depreciation expense was $15.0 million and $14.0 million for the three months ended June 30, 2010 and 2009, and $30.5 million and $26.7 million for the six months ended June 30, 2010 and 2009, respectively.

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Note 4: Intangible Assets

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

	At June 30, 2010			At December 31, 2009		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	$ 366,175	$ (247,896)	$ 118,279	$ 398,043	$ (244,545)	$ 153,498
Customer contracts and relationships	267,365	(93,021)	174,344	306,061	(92,187)	213,874
Trademarks and trade names	70,608	(55,253)	15,355	77,439	(57,957)	19,482
Other	23,953	(22,901)	1,052	24,713	(23,355)	1,358
Total intangible assets	$ 728,101	$ (419,071)	$ 309,030	$ 806,256	$ (418,044)	$ 388,212

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

	Six Months Ended June 30,	
	2010	2009
	(in thousands)	
Beginning balance, intangible assets, gross	$ 806,256	$ 796,236
Effect of change in exchange rates	(78,155)	(3,685)
Ending balance, intangible assets, gross	$ 728,101	$ 792,551

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

Intangible asset amortization expense is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in millions)			
Amortization of intangible assets	$ 16.8	$ 24.2	$ 34.6	$ 47.7

Estimated future annual amortization expense is as follows:

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

2010 (amount remaining at June 30, 2010)	$	32,700
2011		55,950
2012		42,834
2013		34,557
2014		28,330
Beyond 2014		114,659
Total intangible assets, net	$	309,030

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Note 5: Goodwill

The following table reflects goodwill allocated to each reporting segment at June 30, 2010 and 2009:

	Itron North America	Itron International	Total Company
	(in thousands)		
Goodwill balance at January 1, 2009	$ 193,598	$ 1,092,255	$ 1,285,853
Adjustment of previous acquisitions	2,100	-	2,100
Effect of change in exchange rates	596	(10,285)	(9,689)
Goodwill balance at June 30, 2009	$ 196,294	$ 1,081,970	$ 1,278,264
Goodwill balance at January 1, 2010	$ 197,515	$ 1,108,084	$ 1,305,599
Effect of change in exchange rates	89	(159,606)	(159,517)
Goodwill balance at June 30, 2010	$ 197,604	$ 948,478	$ 1,146,082

Due to continued refinements of our management and geographic reporting structures, minor amounts of goodwill have been reallocated between our reporting segments. Historical segment information has been revised to conform to our current segment reporting structure.

In 2009, the *adjustment of previous acquisitions* represents contingent consideration that became payable associated with two acquisitions completed in 2006.

Note 6: Debt

The components of our borrowings are as follows:

	At June 30, 2010	At December 31, 2009
	(in thousands)	
Term loans		
USD denominated term loan	$ 251,667	$ 284,693
EUR denominated term loan	208,548	288,902
Convertible senior subordinated notes	213,126	208,169
	673,341	781,764
Current portion of long-term debt	(10,182)	(10,871)
Total long-term debt	$ 663,159	$ 770,893

Credit Facility

Our credit facility is dated April 18, 2007 and includes two amendments dated April 24, 2009 and February 10, 2010. The principal balance of our euro denominated term loan at June 30, 2010 and December 31, 2009 was 169.1 million and 200.8 million, respectively. Interest rates on the credit facility are based on the respective borrowing s denominated London Interbank Offered Rate (LIBOR) or the Wells Fargo Bank, National

Association s prime rate, plus an additional margin subject to our consolidated leverage ratio. The additional interest rate margin was 3.50% at June 30, 2010 and 3.75% at December 31, 2009. Our interest rates were 3.86% for the U.S. dollar denominated and 4.14% for the euro denominated term loans at June 30, 2010. Scheduled amortization of principal payments is 1% per year (0.25% quarterly) with an excess cash flow provision for additional annual principal repayment requirements. The amount of the excess cash flow provision payment varies according to our consolidated leverage ratio. Maturities of the term loans and multicurrency revolving line of credit are in April 2014 and 2013, respectively. The credit facility is secured by substantially all of the assets of Itron, Inc. and our U.S. domestic operating subsidiaries and includes covenants, which contain certain financial ratios and place restrictions on the incurrence of debt, the payment of dividends, certain investments, incurrence of capital expenditures above a set limit, and mergers.

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The credit facility includes a multicurrency revolving line of credit, which was increased from $115 million to $240 million on June 9, 2010. The increase was completed without amending the credit facility. Prepaid debt fees of $1.1 million were capitalized associated with the increase in the credit line. There were no other changes to the credit facility.

At June 30, 2010, there were no borrowings outstanding under the revolving line of credit, and $30.1 million was utilized by outstanding standby letters of credit resulting in $209.9 million being available for additional borrowings.

We repaid $21.1 million and $73.9 million of the term loans during the three and six months ended June 30, 2010, respectively. Repayments of $2.7 million and $70.2 million were made during the three and six months ended June 30, 2009, respectively. These repayments were made with cash flows from operations and cash on hand. We were in compliance with the debt covenants under the credit facility at June 30, 2010.

Convertible Senior Subordinated Notes

On August 4, 2006, we issued $345 million of 2.50% convertible notes due August 2026. Fixed interest payments are required every six months, in February and August of each year. For each six month period beginning August 2011, contingent interest payments of approximately 0.19% of the average trading price of the convertible notes will be made if certain thresholds are met or events occur, as outlined in the indenture. The convertible notes are registered with the SEC and are generally transferable. Our convertible notes are not considered conventional convertible debt as the number of shares, or cash, to be received by the holders was not fixed at the inception of the obligation. We have concluded that the conversion feature of our convertible notes does not need to be bifurcated from the host contract and accounted for as a freestanding derivative, as the conversion feature is indexed to our own stock and would be classified within stockholders equity if it were a freestanding instrument.

The convertible notes may be converted at the option of the holder at a conversion rate of 15.3478 shares of our common stock for each $1,000 principal amount of the convertible notes, under the following circumstances, as defined in the indenture:

- if the closing sale price per share of our common stock exceeds $78.19, which is 120% of the conversion price of $65.16, for at least 20 trading days in the 30 consecutive trading day period ending on the last trading day of the preceding fiscal quarter;
- between July 1, 2011 and August 1, 2011, and any time after August 1, 2024;
- during the five business days after any five consecutive trading day period in which the trading price of the convertible notes for each day was less than 98% of the average conversion value of the convertible notes;
- if the convertible notes are called for redemption;
- if a fundamental change occurs; or

upon the occurrence of defined corporate events.

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The amount payable upon conversion is the result of a formula based on the closing prices of our common stock for 20 consecutive trading days following the date of the conversion notice. Based on the conversion ratio of 15.3478 shares per $1,000 principal amount of the convertible notes, if our stock price is lower than the conversion price of $65.16, the amount payable will be less than the $1,000 principal amount and will be settled in cash. Our closing stock price at June 30, 2010 was $61.82 per share.

Upon conversion, the principal amount of the convertible notes will be settled in cash and, at our option, the remaining conversion obligation (stock price in excess of conversion price) may be settled in cash, shares, or a combination. The conversion rate for the convertible notes is subject to adjustment upon the occurrence of certain corporate events, as defined in the indenture, to ensure that the economic rights of the convertible note holders are preserved.

The convertible notes also contain purchase options, at the option of the holders, which if exercised would require us to repurchase all or a portion of the convertible notes on August 1, 2011, August 1, 2016, and August 1, 2021 at 100% of the principal amount, plus accrued and unpaid interest.

On or after August 1, 2011, we have the option to redeem all or a portion of the convertible notes at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest.

The convertible notes are unsecured, subordinated to our credit facility (senior secured borrowings), and are guaranteed by one U.S. subsidiary, which is 100% owned. The convertible notes contain covenants, which place restrictions on the incurrence of debt and certain mergers. We were in compliance with these debt covenants at June 30, 2010.

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At June 30, 2010 and December 31, 2009, the contingent conversion threshold was not exceeded and, therefore, the aggregate principal amount of the convertible notes is included in long-term debt. The contingent conversion threshold may be triggered during any quarter prior to July 2011, and the notes become convertible, as our stock price is subject to fluctuation. Effective July 1, 2010, we will classify the convertible notes as current on the Consolidated Balance Sheet due to the combination of put, call, and conversion options occurring within the next 12 months.

Our convertible notes were separated between the liability and equity components, in a manner that reflected our non-convertible debt borrowing rate. Our non-convertible debt borrowing rate at the time of our convertible notes issuance was determined to be 7.38%, which also reflects the effective interest rate on the liability component. The carrying amounts of the debt and equity components are as follows:

	At June 30, 2010	At December 31, 2009
	(in thousands)	
Face value of convertible debt	$ 223,604	$ 223,604
Unamortized discount	(10,478)	(15,435)
Net carrying amount of debt component	$ 213,126	$ 208,169
Carrying amount of equity component	$ 31,831	$ 31,831

The interest expense relating to both the contractual interest coupon and amortization of the discount on the liability component are as follows:

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
	(in thousands)			
Contractual interest coupon	$ 1,397	$ 1,397	$ 2,795	$ 3,044
Amortization of the discount on the liability component	2,501	2,324	4,957	4,895
Total interest expense	$ 3,898	$ 3,721	$ 7,752	$ 7,939

Due to the combination of put, call, and conversion options that are part of the terms of the convertible note agreement, the remaining discount on the liability component will be amortized over 12 months.

During the first quarter of 2009, we entered into exchange agreements with certain holders of our convertible notes to issue, in the aggregate, approximately 2.3 million shares of common stock, valued at $132.9 million, in exchange for, in the aggregate, $121.0 million principal amount of the convertible notes, representing 35% of the aggregate principal outstanding at the date of the exchanges. All of the convertible notes we acquired pursuant to the exchange agreements were retired upon the closing of the exchanges.

The exchange agreements were treated as induced conversions as the holders received a greater number of shares of common stock than would have been issued under the original conversion terms of the convertible notes. At the time of the exchange agreements, none of the conversion contingencies were met. Under the original terms of the convertible notes, the amount payable on conversion was to be paid in cash, and the remaining conversion obligation (stock price in excess of conversion price) was payable in cash or shares of common stock, at our option. Under the terms of the exchange agreements, all of the settlement was paid in shares. The difference in the value of the shares of common stock issued under the exchange agreement and the value of the shares of common stock used to derive the amount payable under the original conversion agreement resulted in a loss on extinguishment of debt of $23.3 million (the inducement loss). Upon derecognition of the convertible notes, we remeasured the fair value of the liability and equity components using a borrowing rate for similar non-convertible debt that would be applicable to us at the date of the exchange agreements. Because borrowing rates increased, the remeasurement of the components of the convertible notes resulted in a gain on extinguishment of $13.4 million (the revaluation gain). As a result, we recognized a net loss on extinguishment of debt of $10.3 million, calculated as the inducement loss, plus an allocation of advisory fees, less the revaluation gain. The remaining settlement consideration of $9.5 million, including an allocation of advisory fees, was recorded as a reduction of common stock.

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Note 7: Derivative Financial Instruments and Hedging Activities

As part of our risk management strategy, we use derivative instruments to hedge certain foreign currency and interest rate exposures. Refer to Note 1, Note 12, and Note 13 for additional disclosures on our derivative instruments.

The fair values of our derivative instruments are determined using the income approach and significant other observable inputs (also known as Level 2), as defined by Accounting Standards Codification (ASC) 820-10-20, *Fair Value Measurements*. We have used observable market inputs based on the type of derivative and the nature of the underlying instrument. The key inputs used at June 30, 2010 included interest rate yield curves (swap rates and futures) and foreign exchange spot and forward rates, all of which are available in an active market. We have utilized the mid-market pricing convention for these inputs at June 30, 2010. 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 net asset position. We consider our own nonperformance risk when the net fair value of our derivative instruments is in a net liability position by discounting our derivative liabilities to reflect the potential credit risk to our counterparty through applying a current market indicative credit spread to all cash flows.

The fair values of our derivative instruments determined using the fair value measurement of significant other observable inputs (Level 2) at June 30, 2010 and December 31, 2009 are as follows:

		Fair Value	
	Balance Sheet Location	At June 30, 2010	At December 31, 2009
Asset Derivatives		(in thousands)	
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current assets	$ 74	$ 3,986
Liability Derivatives			
Derivatives designated as hedging instruments under ASC 815-20			
Interest rate swap contracts	Other current liabilities	$ (8,453)	$ (11,478)
Interest rate swap contracts	Other noncurrent obligations	(2,315)	(3,676)
Euro denominated term loan *	Current portion of long-term debt	(4,131)	(4,820)
Euro denominated term loan *	Long-term debt	(204,417)	(284,082)
Total derivatives designated as hedging instruments under Subtopic 815-20		$ (219,316)	$ (304,056)
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current liabilities	$ (271)	$ (2,442)
Total liability derivatives		$ (219,587)	$ (306,498)

* The euro denominated term loan is a nonderivative financial instrument designated as a hedge of our net investment in international operations. It is recorded at its carrying value in the Consolidated Balance Sheets and is not recorded at fair value.

OCI during the reporting period for our derivative and nonderivative instruments designated as hedging instruments (collectively, hedging instruments), net of tax, was as follows:

	2010	2009

	(in thousands)	
Net unrealized loss on hedging instruments at January 1,	$ (30,300)	$ (29,772)
Unrealized gain (loss) on derivative instruments	(2,542)	(3,804)
Unrealized gain (loss) on a nonderivative net investment hedging instrument	24,352	2,848
Realized (gains) losses reclassified into net income (loss)	4,197	3,803
Net unrealized loss on hedging instruments at June 30,	$ (4,293)	$ (26,925)

Cash Flow Hedges

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

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We have entered into one-year pay-fixed receive one-month LIBOR interest rate swaps to convert $200 million of our U.S. dollar term loan from a floating LIBOR interest rate to a fixed interest rate as follows:

Transaction Date	Effective Date of Swap	Notional amount (in thousands)	Fixed Interest Rate
October 27, 2008	June 30, 2009 - June 30, 2010	$ 200,000	2.68%
July 1, 2009	June 30, 2010 - June 30, 2011	$ 100,000	2.15%
July 1, 2009	June 30, 2010 - June 30, 2011	$ 100,000	2.11%

At June 30, 2010 and December 31, 2009, our U.S. dollar term loan had a balance of $251.7 million and $284.7 million, respectively. The cash flow hedges have been and are expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk through the term of the hedge. Consequently, effective changes in the fair value of the interest rate swap are recorded as a component of OCI and are recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as adjustments to interest expense. The amount of net losses expected to be reclassified into earnings in the next 12 months is approximately $3.1 million, which was based on the Bloomberg U.S. dollar swap yield curve as of June 30, 2010.

In 2007, we entered into a pay fixed 6.59% receive three-month Euro Interbank Offered Rate (EURIBOR), plus 2%, amortizing interest rate swap to convert a significant portion of our euro denominated variable-rate term loan to fixed-rate debt, plus or minus the variance in the applicable margin from 2%, through December 31, 2012. The cash flow hedge is currently, and is expected to be, highly effective in achieving offsetting cash flows attributable to the hedged risk through the term of the hedge. Consequently, effective changes in the fair value of the interest rate swap are recorded as a component of OCI and are recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as adjustments to interest expense. The notional amount of the swap is reduced each quarter and was $177.7 million (144.1 million) and $252.9 million (175.8 million) as of June 30, 2010 and December 31, 2009, respectively. The amount of net losses expected to be reclassified into earnings in the next 12 months is approximately $5.4 million (4.4 million), which was based on the Bloomberg euro swap yield curve as of June 30, 2010.

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

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

Derivatives in ASC 815-20 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)			Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)		
			Location	Amount		Location	Amount	
	2010	2009		2010	2009		2010	2009
	(in thousands)			(in thousands)			(in thousands)	
Three months ended June 30,								
Interest rate swap contracts	$ (839)	$ (1,658)	Interest expense	$ (3,238)	$ (3,605)	Interest expense	$ (14)	$ (136)
Six months ended June 30,								
Interest rate swap contracts	$ (4,122)	$ (6,165)	Interest expense	$ (6,810)	$ (6,162)	Interest expense	$ (74)	$ (184)

Net Investment Hedge

We are exposed to foreign exchange risk through our international subsidiaries. As a result of our acquisition of an international company in 2007, we entered into a euro denominated term loan, which exposes us to fluctuations in the euro foreign exchange rate. Therefore, we have designated this foreign currency denominated term loan as a hedge of our net investment in international operations. The non-functional currency term loan is revalued into U.S. dollars at each balance sheet date, and the changes in value associated with currency fluctuations are recorded as adjustments to long-term debt with offsetting gains and losses recorded in OCI. The notional amount of the term loan declines each quarter due to repayments and was $208.5 million (169.1 million) and $288.9 million (200.8 million) as of June 30, 2010 and December 31, 2009, respectively. We had no hedge ineffectiveness.

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The before tax and net of tax effect of our net investment hedge nonderivative financial instrument on OCI for the three and six months ended June 30 are as follows:

Nonderivative Financial Instruments in ASC 815-20 Net Investment Hedging Relationships	Euro Denominated Term Loan Designated as a Hedge of Our Net Investment in International Operations			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Gain (loss) recognized in OCI on derivative (Effective Portion)				
Before tax	$ 20,943	$ (18,328)	$ 39,498	$ 4,613
Net of tax	$ 12,908	$ (11,325)	$ 24,352	$ 2,848

Derivatives Not Designated as Hedging Relationships

We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third-party. At each period-end, foreign currency monetary assets and liabilities are revalued with the change recorded to other income and expense. We enter into monthly foreign exchange forward contracts, not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain of these balances. During the six months ended June 30, 2010, we entered into 51 foreign currency option and forward transactions. The notional amounts of the contracts ranged from less than $1 million to $48 million, offsetting our exposures from the euro, British pound, Canadian dollar, Czech koruna, Hungarian forint, and various other currencies.

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

Derivatives Not Designated as Hedging Instrument under ASC 815-20	Gain (Loss) Recognized on Derivatives in Other Income (Expense)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Foreign exchange option and forward contracts	$ 3,316	$ (606)	$ 3,047	$ (527)

Note 8: Defined Benefit Pension Plans

We sponsor both funded and unfunded defined benefit pension plans for our employees in Germany, France, Spain, Italy, Belgium, Chile, Portugal, Hungary, and Indonesia offering death and disability, retirement, and special termination benefits. The defined benefit obligation is calculated annually by using the projected unit credit method. The measurement date for the pension plans was December 31, 2009.

Amounts recognized on the Consolidated Balance Sheets consist of:

	At June 30, 2010	At December 31, 2009
	(in thousands)	
Current portion of pension plan liability in wages and benefits payable	$ 2,872	$ 2,975
Long-term portion of pension plan liability	54,953	63,040
Plan assets in other noncurrent assets	(518)	(613)
Net pension plan benefit liability	$ 57,307	$ 65,402

The decrease in the net pension plan liability from December 31, 2009 to June 30, 2010 is primarily due to the decrease in the value of the euro, as compared with the U.S. dollar. Our defined benefit pension plans are denominated in the functional currencies of the respective countries in which the plans are sponsored.

Our general funding policy for these qualified pension plans is to contribute amounts sufficient to satisfy regulatory funding standards of the respective countries for each plan. We contributed $313,000 and $338,000 to the defined benefit pension plans for the three and six months ended June 30, 2010, and $30,000 and $53,000 for the three and six months ended June 30, 2009, respectively. The timing of when contributions are made can vary by plan from year to year. For 2010, assuming that actual plan asset returns are consistent with our expected rate of return, and that interest rates remain constant, we expect to contribute approximately $500,000 in 2010 to our defined benefit pension plans. We contributed $397,000 to the defined benefit pension plans for the year ended December 31, 2009.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Service cost	$ 475	$ 419	$ 1,000	$ 868
Interest cost	844	886	1,750	1,740
Expected return on plan assets	(71)	(72)	(148)	(141)
Amortization of actuarial net gain	(6)	(99)	(13)	(182)
Amortization of unrecognized prior service costs	-	7	-	13
Net periodic benefit cost	$ 1,242	$ 1,141	$ 2,589	$ 2,298

Note 9: Stock-Based Compensation

We record stock-based compensation expense for awards of stock options, stock sold pursuant to our ESPP, and the issuance of restricted and unrestricted stock awards and units. We expense stock-based compensation using the straight-line method over the vesting requirement period. For the three and six months ended June 30, stock-based compensation expense and the related tax benefit were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Stock options	$ 952	$ 2,262	$ 2,295	$ 4,572
Restricted stock awards and units	3,441	2,377	6,382	4,293
Unrestricted stock awards	14	15	189	135
ESPP	138	138	255	279
Total stock-based compensation	$ 4,545	$ 4,792	$ 9,121	$ 9,279
Related tax benefit	$ 1,324	$ 1,192	$ 2,732	$ 2,456

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

The fair value of stock options and ESPP awards issued were estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Employee Stock Options			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2010 (1)	2009 (1)	2010	2009