

ITRON INC /WA/
Form 10-Q
November 03, 2016

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

FORM 10-Q

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

For the quarterly period ended September 30, 2016

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 No

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

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

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

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

As of September 30, 2016 there were outstanding 38,258,576 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

Table of Contents

Itron, Inc.
Table of Contents

	Page
<u>PART I: FINANCIAL INFORMATION</u>	
Item 1: <u>Financial Statements (Unaudited)</u>	
<u>Consolidated Statements of Operations</u>	<u>1</u>
<u>Consolidated Statements of Comprehensive Income (Loss)</u>	<u>2</u>
<u>Consolidated Balance Sheets</u>	<u>3</u>
<u>Consolidated Statements of Cash Flows</u>	<u>4</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>5</u>
Item 2: <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
Item 3: <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>48</u>
Item 4: <u>Controls and Procedures</u>	<u>50</u>
<u>PART II: OTHER INFORMATION</u>	
Item 1: <u>Legal Proceedings</u>	<u>51</u>
Item 1A: <u>Risk Factors</u>	<u>51</u>
Item 2: <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>51</u>
Item 5: <u>Other Information</u>	<u>51</u>
Item 6: <u>Exhibits</u>	<u>52</u>
<u>SIGNATURE</u>	<u>53</u>

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1: Financial Statements (Unaudited)

ITRON, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(in thousands, except per share data)			
Revenues	\$506,859	\$469,528	\$1,517,473	\$1,387,085
Cost of revenues	336,110	322,238	1,013,816	982,819
Gross profit	170,749	147,290	503,657	404,266
Operating expenses				
Sales and marketing	38,894	39,217	119,037	123,302
Product development	39,386	41,559	128,086	126,399
General and administrative	40,384	31,118	130,781	103,195
Amortization of intangible assets	4,996	7,869	19,002	23,730
Restructuring	40,679	587	41,294	(8,828)
Total operating expenses	164,339	120,350	438,200	367,798
Operating income	6,410	26,940	65,457	36,468
Other income (expense)				
Interest income	102	180	594	440
Interest expense	(2,691)	(2,799)	(8,344)	(9,336)
Other income (expense), net	707	(1,119)	(1,074)	(3,003)
Total other income (expense)	(1,882)	(3,738)	(8,824)	(11,899)
Income before income taxes	4,528	23,202	56,633	24,569
Income tax provision	(13,430)	(9,932)	(34,249)	(19,060)
Net income (loss)	(8,902)	13,270	22,384	5,509
Net income attributable to noncontrolling interests	983	630	2,263	1,817
Net income (loss) attributable to Itron, Inc.	\$(9,885)	\$12,640	\$20,121	\$3,692
Earnings (loss) per common share - Basic	\$(0.26)	\$0.33	\$0.53	\$0.10
Earnings (loss) per common share - Diluted	\$(0.26)	\$0.33	\$0.52	\$0.10
Weighted average common shares outstanding - Basic	38,248	38,114	38,181	38,329
Weighted average common shares outstanding - Diluted	38,248	38,358	38,515	38,591

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

Table of Contents

ITRON, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income (loss)	\$(8,902)	\$13,270	\$22,384	\$5,509
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	9,184	(14,241)	10,910	(60,803)
Net unrealized gain (loss) on derivative instruments, designated as cash flow hedges	542	71	(3,190)	80
Pension benefit obligation adjustment	(1,198)	866	(1,807)	1,863
Total other comprehensive income (loss), net of tax	8,528	(13,304)	5,913	(58,860)
Total comprehensive income (loss), net of tax	(374)	(34)	28,297	(53,351)
Comprehensive income attributable to noncontrolling interests, net of tax	983	630	2,263	1,817
Comprehensive income (loss) attributable to Itron, Inc.	\$(1,357)	\$(664)	\$26,034	\$(55,168)

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

Table of Contents

ITRON, INC.

CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	September 30, 2016	December 31, 2015
	(in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 151,380	\$ 131,018
Accounts receivable, net	368,710	330,895
Inventories	189,553	190,465
Other current assets	122,037	106,562
Total current assets	831,680	758,940
Property, plant, and equipment, net	180,867	190,256
Deferred tax assets noncurrent, net	91,808	109,387
Other long-term assets	45,332	51,679
Intangible assets, net	82,733	101,932
Goodwill	475,705	468,122
Total assets	\$ 1,708,125	\$ 1,680,316
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	\$ 203,986	\$ 185,827
Other current liabilities	49,340	78,630
Wages and benefits payable	88,519	76,980
Taxes payable	18,295	14,859
Current portion of debt	12,656	11,250
Current portion of warranty	26,084	36,927
Unearned revenue	80,342	73,301
Total current liabilities	479,222	477,774
Long-term debt	330,042	358,915
Long-term warranty	18,702	17,585
Pension benefit obligation	86,310	85,971
Deferred tax liabilities noncurrent, net	1,680	1,723
Other long-term obligations	130,177	115,645
Total liabilities	1,046,133	1,057,613
Commitments and contingencies (Note 11)		
Equity		
Preferred stock, no par value, 10 million shares authorized, no shares issued or outstanding—	—	—
Common stock, no par value, 75 million shares authorized, 38,259 and 37,906 shares issued and outstanding	1,259,704	1,246,671
Accumulated other comprehensive loss, net	(194,694)	(200,607)
Accumulated deficit	(421,185)	(441,306)
Total Itron, Inc. shareholders' equity	643,825	604,758
Noncontrolling interests	18,167	17,945

Edgar Filing: ITRON INC /WA/ - Form 10-Q

Total equity	661,992	622,703
Total liabilities and equity	\$1,708,125	\$1,680,316

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

3

Table of Contents

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

	Nine Months Ended September 30, 2016		2015	
	(in thousands)			
Operating activities				
Net income	\$	22,384	\$	5,509
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	51,563		57,790	
Stock-based compensation	13,300		10,879	
Amortization of prepaid debt fees	806		1,851	
Deferred taxes, net	17,772		14,744	
Restructuring, non-cash	5,153		1,018	
Other adjustments, net	(734	)	1,877	
Changes in operating assets and liabilities:				
Accounts receivable	(32,652	)	(14,193)
Inventories	3,207		(73,464)
Other current assets	(15,591	)	(998)
Other long-term assets	8,499		(2,529)
Accounts payable, other current liabilities, and taxes payable	(5,830	)	(11,119)
Wages and benefits payable	11,516		3,787	
Unearned revenue	(8,684	)	6,536	
Warranty	(9,900	)	20,207	
Other operating, net	21,072		(1,741)
Net cash provided by operating activities	81,881		20,154	
Investing activities				
Acquisitions of property, plant, and equipment	(30,563	)	(33,324)
Business acquisitions, net of cash and cash equivalents acquired	(951	)	(5,754)
Other investing, net	(1,258	)	545	

Net cash used in investing activities	(32,772)	)	(38,533))
Financing activities				
Proceeds from borrowings	—		89,709	
Payments on debt	(29,031)	)	(30,186))
Issuance of common stock	1,993		2,229	
Repurchase of common stock	—		(35,278))
Other financing, net	(3,658)	)	1,881	
Net cash provided by (used in) financing activities	(30,696)	)	28,355	
Effect of foreign exchange rate changes on cash and cash equivalents	1,949		(12,889))
Increase (decrease) in cash and cash equivalents	20,362		(2,913))
Cash and cash equivalents at beginning of period	131,018		112,371	
Cash and cash equivalents at end of period	\$ 151,380		\$ 109,458	
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Income taxes, net	\$ 17,207		\$ 22,578	
Interest, net of amounts capitalized	7,592		7,549	

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

Table of Contents

ITRON, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

(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

Financial Statement Preparation

The condensed consolidated financial statements presented in this Quarterly Report on Form 10-Q are unaudited and reflect entries necessary for the fair presentation of the Consolidated Statements of Operations and the Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2016 and 2015, the Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015 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. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

Certain information and notes normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim results. These condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes included in our 2015 Annual Report on Form 10-K filed with the SEC on June 30, 2016. There have been no significant changes in financial statement preparation or significant accounting policies since December 31, 2015, with the following exceptions.

Revision of Prior Period Financial Statements

We revised our previously reported consolidated financial statements for the first three quarters of fiscal 2015 as reported in our 2015 Annual Report on Form 10-K filed with the SEC on June 30, 2016. These revisions primarily impacted the timing of revenue and cost recognition associated with contracts involving certain software products that we were unable to demonstrate vendor specific objective evidence (VSOE) of fair value for certain undelivered elements or determine whether software was essential to the functionality of certain hardware. All impacted financial statement line items and related notes to condensed consolidated financial statements reflect these revisions.

Prepaid Debt Fees

Prepaid debt fees for term debt represent the capitalized direct costs incurred related to the issuance of debt and are recorded as a direct deduction from the carrying amount of the corresponding debt liability. We have elected to present prepaid debt fees for revolving debt within other long-term assets in the Consolidated Balance Sheets. These costs are amortized to interest expense over the terms 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.

Stock-Based Compensation

We grant various stock-based compensation awards to our officers, employees and Board of Directors with service, market, and/or performance vesting conditions. Beginning with the fiscal quarter ended March 31, 2016, we granted phantom stock units, which are settled in cash upon vesting and accounted for as liability-based awards.

We measure and recognize compensation expense for all stock-based compensation based on estimated fair values. The fair value of stock options is estimated at the date of grant using the Black-Scholes option-pricing model, which

includes assumptions for the dividend yield, expected volatility, risk-free interest rate, and expected term. For unrestricted stock awards with no market conditions, the fair value is the market close price of our common stock on the date of grant. For restricted stock units with market conditions, the fair value is estimated at the date of award using a Monte Carlo simulation model, which includes assumptions for dividend yield and expected volatility for our common stock and the common stock for companies within the Russell 3000 index, as well as the risk-free interest rate and expected term of the awards. For phantom stock units, fair value is the market close price of our common stock at the end of each reporting period.

We expense stock-based compensation at the date of grant for unrestricted stock awards. For awards with only a service condition, we expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the requisite service period for the entire award. For awards with performance and service conditions, if vesting is probable, we expense the stock-based compensation, adjusted for estimated forfeitures, on a straight-line basis over the requisite service period for each separately

Table of Contents

vesting portion of the award. For awards with a market condition, we expense the fair value over the requisite service period. Excess tax benefits are credited to common stock when the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the Consolidated Statements of Cash Flows.

Certain of our employees are eligible to participate in our Employee Stock Purchase Plan (ESPP). The discount provided for ESPP purchases is 5% from the fair market value of the stock at the end of each fiscal quarter and is not considered compensatory.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date for implementation of ASU 2014-09 by one year and are now effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted but not earlier than the original effective date. In March 2016, the FASB issued ASU 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (ASU 2016-08), which clarifies the implementation guidance of principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, Identifying Performance Obligations and Licensing (ASU 2016-10), which clarifies the identification of performance obligations and licensing implementation guidance. In May 2016, the FASB issued ASU 2016-12, Narrow-Scope Improvements and Practical Expedients (ASU 2016-12), to improve guidance on assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition. The effective date and transition requirements in ASU 2016-08, ASU 2016-10, and ASU 2016-12 are the same as the effective date and transition requirements of ASU 2015-14. We have not yet selected a transition method, and we are currently evaluating the effect that the updated standard will have on our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

In April 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest (ASU 2015-03). ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the corresponding debt liability. In August 2015, the FASB issued ASU 2015-15, Interest - Imputation of Interest: Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (ASU 2015-15). ASU 2015-15 provides additional guidance on the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. ASU 2015-03 and ASU 2015-15 are effective for interim and annual periods beginning after December 15, 2015, with early adoption permitted, and is to be applied on a retrospective basis. We adopted this standard on January 1, 2016, and it did not materially impact our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

In April 2015, the FASB issued ASU 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40), Customer's Accounting for Fees Paid in a Cloud Computing Arrangement (ASU 2015-05), which provides guidance about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 is effective for us on January 1, 2016. We adopted this standard on January 1, 2016, and it did not materially impact our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330) - Simplifying the Measurement of Inventory (ASU 2015-11). The amendments in ASU 2015-11 apply to inventory measured using first-in, first-out (FIFO) or average cost and will require entities to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the normal course of business, minus the cost of completion, disposal and transportation. Replacement cost and net realizable value less a normal profit margin will no longer be considered. ASU 2015-11 is effective for us on January 1, 2017. We are currently assessing the impact of adoption on our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires substantially all leases be recognized by lessees on their balance sheet as a right-of-use asset and corresponding lease liability, including leases currently accounted for as operating leases. The new standard also will result in enhanced quantitative and qualitative disclosures, including significant judgments made by management, to provide greater insight into the extent of revenue and expense recognized and expected to be recognized from existing leases. The standard requires modified retrospective adoption and will be effective for annual reporting periods beginning after December 15, 2018, with early adoption permitted. We are currently assessing the impact of adoption on our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

Table of Contents

In March 2016, the FASB issued ASU 2016-07, Investments - Equity Method and Joint Ventures (Topic 323) (ASU 2016-07), which simplified the accounting for equity method investments by eliminating the requirement that an entity retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership or degree of influence. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. ASU 2016-07 is effective for us on January 1, 2017. The adoption of this guidance is not expected to have a material impact on our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718) (ASU 2016-09), which simplifies several areas within Topic 718. These include the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for us on January 1, 2017, with early adoption permitted. We are currently assessing the basis of adoption and evaluating the impact of the adoption of the update on our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

Note 2: Earnings Per Share

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

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
	2015	2016	2015	2016
	(in thousands, except per share data)			
Net income (loss) available to common shareholders	\$ (9,885)	\$ 12,640	\$ 20,121	\$ 3,692
Weighted average common shares outstanding - Basic	38,248	38,114	38,181	38,329
Dilutive effect of stock-based awards	—	244	334	262
Weighted average common shares outstanding - Diluted	38,248	38,358	38,515	38,591
Earnings (loss) per common share - Basic	\$(0.26)	\$0.33	\$0.53	\$0.10
Earnings (loss) per common share - Diluted	\$(0.26)	\$0.33	\$0.52	\$0.10

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 0.9 million and 0.8 million stock-based awards were excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2016 because they were anti-dilutive. Approximately 1.1 million and 1.2 million stock-based awards were excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2015 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Note 3: Certain Balance Sheet Components

Accounts receivable, net	September 30, December 31,	
	2016	2015
	(in thousands)	
Trade receivables (net of allowance of \$4,254 and \$5,949)	\$ 319,929	\$ 298,550
Unbilled receivables	48,781	32,345
Total accounts receivable, net	\$ 368,710	\$ 330,895

At September 30, 2016 and December 31, 2015, \$4.6 million and \$0.7 million, respectively, were recorded as contract retainage receivables within trade receivables, in accordance with contract retainage provisions. At September 30, 2016 and December 31, 2015, contract retainage receivables that were unbilled and classified as unbilled receivables were \$5.4 million and \$3.5 million, respectively. These contract retainage receivables within trade receivables and unbilled receivables are expected to be collected within the following 12 months.

Table of Contents

At September 30, 2016 and December 31, 2015, long-term billed contract retainage receivables were \$0.4 million. At September 30, 2016 and December 31, 2015, long-term unbilled contract retainage receivables were \$3.8 million and \$3.6 million, respectively. These long-term billed and unbilled contract retainage receivables are classified within other long-term assets, as collection is not anticipated within the following 12 months. We consider whether collectability of such retainage is reasonably assured in connection with our overall assessment of the collectability of amounts due or that will become due under our contracts.

Allowance for doubtful accounts activity	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(in thousands)			
Beginning balance	\$3,939	\$5,422	\$5,949	\$6,195
Provision (release) for doubtful accounts, net	353	(141)	265	(111)
Accounts written-off	(77)	(162)	(1,919)	(503)
Effect of change in exchange rates	39	(160)	(41)	(622)
Ending balance	\$4,254	\$4,959	\$4,254	\$4,959

Inventories	September 30 / December 31,	
	2016	2015
	(in thousands)	
Materials	\$112,507	\$111,191
Work in process	9,919	9,400
Finished goods	67,127	69,874
Total inventories	\$189,553	\$190,465

Consigned inventory is held at third party locations; however, we retain title to the inventory until it is purchased by the third party. Consigned inventory, consisting of raw materials and finished goods, was \$2.1 million and \$2.6 million at September 30, 2016 and December 31, 2015, respectively.

Property, plant, and equipment, net	September 30 / December 31,	
	2016	2015
	(in thousands)	
Machinery and equipment	\$290,395	\$289,015
Computers and software	105,791	104,310
Buildings, furniture, and improvements	127,297	127,531
Land	18,069	19,882
Construction in progress, including purchased equipment	26,956	32,639
Total cost	568,508	573,377
Accumulated depreciation	(387,641)	(383,121)
Property, plant, and equipment, net	\$180,867	\$190,256

Depreciation expense	Three Months		Nine Months	
	Ended September		Ended September	
	30,		30,	
	2016	2015	2016	2015
	(in thousands)			
Depreciation expense	\$11,086	\$11,129	\$32,561	\$34,060

Table of Contents

Note 4: Intangible Assets

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

	September 30, 2016			December 31, 2015		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	\$392,752	\$(370,894)	\$21,858	\$388,981	\$(358,092)	\$30,889
Customer contracts and relationships	236,974	(176,528)	60,446	238,379	(168,885)	69,494
Trademarks and trade names	64,010	(63,619)	391	64,069	(62,571)	1,498
Other	11,080	(11,042)	38	11,078	(11,027)	51
Total intangible assets	\$704,816	\$(622,083)	\$82,733	\$702,507	\$(600,575)	\$101,932

A summary of intangible asset activity is as follows:

	Nine Months Ended	
	September 30, 2016	September 30, 2015
	(in thousands)	
Beginning balance, intangible assets, gross	\$702,507	\$748,148
Intangible assets acquired	—	4,827
Intangible assets impaired	—	(497)
Effect of change in exchange rates	2,309	(41,245)
Ending balance, intangible assets, gross	\$704,816	\$711,233

Intangible assets acquired during the nine months ended September 30, 2015 were related to the Temetra Limited acquisition on August 26, 2015. Intangible assets impaired during the nine months ended September 30, 2015 includes purchased software licenses to be sold to others. This amount was expensed as part of cost of revenues in the Consolidated Statement of Operations.

Estimated future annual amortization expense is as follows:

Year Ending December 31,	Estimated Annual Amortization (in thousands)
2016 (amount remaining at September 30, 2016)	\$ 6,304
2017	18,706
2018	13,015
2019	10,220
2020	8,328
Beyond 2020	26,160
Total intangible assets subject to amortization	\$ 82,733

Table of Contents

Note 5: Goodwill

The following table reflects goodwill allocated to each reporting unit:

	Electricity	Gas	Water	Total Company
	(in thousands)			
Balances at January 1, 2016				
Goodwill before impairment	\$414,910	\$331,436	\$350,314	\$1,096,660
Accumulated impairment losses	(362,177)	—	(266,361)	(628,538)
Goodwill, net	52,733	331,436	83,953	468,122
Effect of change in exchange rates	329	5,843	1,411	7,583
Balances at September 30, 2016				
Goodwill before impairment	421,852	337,279	358,081	1,117,212
Accumulated impairment losses	(368,790)	—	(272,717)	(641,507)
Goodwill, net	\$53,062	\$337,279	\$85,364	\$475,705

Note 6: Debt

The components of our borrowings were as follows:

	September 30, 2016	December 31, 2015
	(in thousands)	
Credit facility:		
USD denominated term loan	\$210,938	\$ 219,375
Multicurrency revolving line of credit	132,597	151,837
Total debt	343,535	371,212
Less: current portion of debt	12,656	11,250
Less: unamortized prepaid debt fees - term loan	837	1,047
Long-term debt less unamortized prepaid debt fees - term loan	\$ 330,042	\$ 358,915

Credit Facility

On June 23, 2015, we entered into an amended and restated credit agreement providing for committed credit facilities in the amount of \$725 million U.S. dollars (the 2015 credit facility). The 2015 credit facility consists of a \$225 million U.S. dollar term loan (the term loan) and a multicurrency revolving line of credit (the revolver) with a principal amount of up to \$500 million. The revolver also contains a \$250 million standby letter of credit sub-facility and a \$50 million swingline sub-facility (available for immediate cash needs at a higher interest rate). Both the term loan and the revolver mature on June 23, 2020, and amounts borrowed under the revolver are classified as long-term and, during the credit facility term, may be repaid and reborrowed until the revolver's maturity, at which time the revolver will terminate, and all outstanding loans, together with all accrued and unpaid interest, must be repaid. Amounts not borrowed under the revolver are subject to a commitment fee, which is paid in arrears on the last day of each fiscal quarter, ranging from 0.175% to 0.30% per annum depending on our total leverage ratio as of the most recently ended fiscal quarter. Amounts repaid on the term loan may not be reborrowed. The 2015 credit facility permits us and certain of our foreign subsidiaries to borrow in U.S. dollars, euros, British pounds, or, with lender approval, other currencies readily convertible into U.S. dollars. All obligations under the 2015 credit facility are guaranteed by Itron, Inc. and material U.S. domestic subsidiaries and are secured by a pledge of substantially all of the assets of Itron, Inc. and material U.S. domestic subsidiaries, including a pledge of 100% of the capital stock of material U.S. domestic subsidiaries and up to 66% of the voting stock (100% of the non-voting stock) of their first-tier foreign subsidiaries. In

addition, the obligations of any foreign subsidiary who is a foreign borrower, as defined by the 2015 credit facility, are guaranteed by the foreign subsidiary and by its direct and indirect foreign parents.

The 2015 credit facility includes debt covenants, which contain certain financial ratio thresholds, place certain restrictions on the incurrence of debt, investments, and the issuance of dividends, and require quarterly unaudited and annual audited financial reporting. We were not in compliance with the financial reporting portion of these covenants under the 2015 credit facility at June 30, 2016. On April 1, 2016 and June 13, 2016, we entered into the first and second amendments to the 2015 credit facility. As a result of these amendments, we were granted waivers that extended the due dates for annual audited financial statements for the year ended December 31, 2015 and quarterly unaudited financial statements for the periods ended March 31, 2016 and June 30, 2016 through September 12, 2016, and our \$300 million standby letter of credit sub-facility was reduced to \$250 million. We regained compliance with all financial reporting covenants upon filing our Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2016 on September 2, 2016.

Table of Contents

Scheduled principal repayments for the term loan are due quarterly in the amount of \$2.8 million through June 2017, \$4.2 million from September 2017 through June 2018, \$5.6 million from September 2018 through March 2020, and the remainder due at maturity on June 23, 2020. The term loan may be repaid early in whole or in part, subject to certain minimum thresholds, without penalty.

Under the 2015 credit facility, we elect applicable market interest rates for both the term loan and any outstanding revolving loans. We also pay an applicable margin, which is based on our total leverage ratio (as defined in the credit agreement). The applicable rates per annum may be based on either: (1) the LIBOR rate or EURIBOR rate (floor of 0%), plus an applicable margin, or (2) the Alternate Base Rate, plus an applicable margin. The Alternate Base Rate election is equal to the greatest of three rates: (i) the prime rate, (ii) the Federal Reserve effective rate plus 1/2 of 1%, or (iii) one month LIBOR plus 1%. At September 30, 2016, the interest rate for both the term loan and the USD revolver was 1.78% (the LIBOR rate plus a margin of 1.25%), and the interest rate for the EUR revolver was 1.25% (the EURIBOR floor rate plus a margin of 1.25%).

Credit facility repayments were as follows:

	Nine Months Ended September 30, 2016 2015 (in thousands)	
USD denominated term loan	\$8,438	\$10,313
Multicurrency revolving line of credit	20,593	19,873
Total credit facility repayments	\$29,031	\$30,186

At September 30, 2016, \$132.6 million was outstanding under the credit facility revolver, and \$321.3 million was available for additional borrowings or standby letters of credit. At September 30, 2016, \$46.1 million was utilized by outstanding standby letters of credit, resulting in \$203.9 million available for additional standby letters of credit. No amounts were outstanding under the swingline sub-facility.

Upon entering into the 2015 credit facility, a portion of our unamortized prepaid debt fees, totaling \$0.8 million, were written-off to interest expense. Prepaid debt fees of approximately \$3.9 million were capitalized associated with the 2015 credit facility. Unamortized prepaid debt fees were as follows:

	September 30, 2016 2015 (in thousands)	
Unamortized prepaid debt fees - revolver	\$2,596	\$ 3,128
Unamortized prepaid debt fees - term loan	837	1,047

Table of Contents

Note 7: Derivative Financial Instruments

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

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

The fair values of our derivative instruments were as follows:

Asset Derivatives	Balance Sheet Location	Fair Value	
		September 30, 2016	December 31, 2015
(in thousands)			
Derivatives designated as hedging instruments under ASC 815-20			
Interest rate swap contracts	Other long-term assets	\$—	\$ 1,632
Interest rate cap contracts	Other long-term assets	240	1,423
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current assets	119	27
Interest rate cap contracts	Other long-term assets	60	—
Total asset derivatives		\$419	\$ 3,082
Liability Derivatives			
Derivatives designated as hedging instruments under ASC 815-20			
Interest rate swap contracts	Other current liabilities	\$1,532	\$ 868
Interest rate swap contracts	Other long-term obligations	1,776	—
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current liabilities	294	99
Total liability derivatives		\$3,602	\$ 967

The changes in accumulated other comprehensive income (loss) (AOCI), net of tax, for our derivative and nonderivative hedging instruments, were as follows:

	2016	2015
	(in thousands)	
Net unrealized loss on hedging instruments at January 1,	\$(14,062)	\$(15,148)
Unrealized loss on hedging instruments	(3,709)	(681)
Realized losses reclassified into net income	519	761
Net unrealized loss on hedging instruments at September 30,	\$(17,252)	\$(15,068)

Reclassification of amounts related to hedging instruments are included in interest expense in the Consolidated Statements of Operations for the periods ended September 30, 2016 and 2015. Included in the net unrealized loss on hedging instruments at September 30, 2016 and 2015 is a loss of \$14.4 million, net of tax, related to our nonderivative net investment hedge, which terminated in 2011. This loss on our net investment hedge will remain in AOCI until such time when earnings are impacted by a sale or liquidation of the associated foreign operation.

Table of Contents

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

Offsetting of Derivative Assets	Gross Amount of Recognized Assets Presented in the Consolidated Balance Sheets (in thousands)	Gross Amounts Not Offset in the Consolidated Balance Sheets	Cash Collateral Received	Net Amount
September 30, 2016	\$419	\$ (119)	\$	—\$ 300
December 31, 2015	\$3,082	\$ (565)	\$	—\$ 2,517

Offsetting of Derivative Liabilities	Gross Amount of Recognized Liabilities Presented in the Consolidated Balance Sheets (in thousands)	Gross Amounts Not Offset in the Consolidated Balance Sheets	Cash Collateral Pledged	Net Amount
September 30, 2016	\$3,602	\$ (119)	\$	—\$ 3,483
December 31, 2015	\$967	\$ (565)	\$	—\$ 402

Our derivative assets and liabilities subject to netting arrangements consist of foreign exchange forward and interest rate contracts with three and nine counterparties at September 30, 2016 and December 31, 2015, respectively. No derivative asset or liability balance with any of our counterparties was individually significant at September 30, 2016 or December 31, 2015. Our derivative contracts with each of these counterparties exist under agreements that provide for the net settlement of all contracts through a single payment in a single currency in the event of default. We have no pledges of cash collateral against our obligations nor have we received pledges of cash collateral from our counterparties under the associated derivative contracts.

Cash Flow Hedges

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

In May 2012, we entered into six interest rate swaps, which were effective July 31, 2013 and expired on August 8, 2016, to 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). The cash flow hedges were expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk through the term of the hedge. Consequently, effective changes in the fair value of the interest rate swaps were recorded as a component of other comprehensive income (loss) (OCI) and recognized in earnings when the hedged item affected earnings. The amounts paid on the hedges were recognized as adjustments to interest expense.

In October 2015, we entered into an interest rate swap, which is effective from August 31, 2016 to June 23, 2020, and converts \$214 million of our LIBOR based debt from a floating LIBOR interest rate to a fixed interest rate of 1.42% (excluding the applicable margin on the debt). The notional balance will amortize to maturity at the same rate as required minimum payments on our term loan. The cash flow hedge 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 is recorded as a component of OCI and will be recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge will be recognized as an adjustment to interest expense. The amount of net losses expected to be reclassified into earnings in the next 12 months is \$1.5 million.

In November 2015, we entered into three interest rate cap contracts with a total notional amount of \$100 million at a cost of \$1.7 million. The interest rate cap contracts expire on June 23, 2020 and were entered into in order to limit our interest rate exposure on \$100 million of our variable LIBOR based debt up to 2.00%. In the event LIBOR is higher than 2.00%, we will pay interest at the capped rate of 2.00% with respect to the \$100 million notional amount of such agreements. The interest rate cap contracts

Table of Contents

do not include the effect of the applicable margin. The amount of net losses expected to be reclassified into earnings in the next 12 months is insignificant.

At September 30, 2016, our LIBOR based debt balance was \$290.9 million. The amount of cash flow hedge ineffectiveness for derivative contracts not designated as hedging instruments was insignificant for the three and nine months ended September 30, 2016 and 2015.

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 effects of our cash flow derivative instruments on the Consolidated Balance Sheets and the Consolidated Statements of Operations were as follows:

Derivatives in ASC 815-20 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Location	Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) Location	
	2016	2015		2016	2015
	(in thousands)		(in thousands)		(in thousands)
Three Months Ended September 30,					
Interest rate swap contracts	\$ 641	\$ (296)	Interest expense	\$ (273) \$ (412)	Interest expense \$ — \$ —
Interest rate cap contracts	(31)	—	Interest expense	(6) —	Interest expense (1) —
Nine Months Ended September 30,					
Interest rate swap contracts	\$ (4,910)	\$ (1,104)	Interest expense	\$ (839) \$ (1,235)	Interest expense \$ — \$ —
Interest rate cap contracts	(1,121)	—	Interest expense	(6) —	Interest expense (1) —

Derivatives Not Designated as Hedging Relationships

We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third party. At each period-end, non-functional currency monetary assets and liabilities are revalued with the change recorded to other income and expense. We enter into monthly foreign exchange forward contracts (a total of 402 contracts were entered into during the nine months ended September 30, 2016), which are not designated for hedge accounting, with the intent to reduce earnings volatility associated with currency exposures. The notional amounts of the contracts ranged from less than \$10,000 to \$37.9 million, offsetting our exposures from the euro, British pound, Canadian dollar, Australian dollar, Mexican peso, and various other currencies.

The effect of our foreign exchange forward derivative instruments on the Consolidated Statements of Operations was as follows:

Derivatives Not Designated as Hedging Instrument under ASC 815-20	Gain (Loss) Recognized on Derivatives in Other Income (Expense)

Edgar Filing: ITRON INC /WA/ - Form 10-Q

	Three Months Ended September 30, 2016 2015		Nine Months Ended September 30, 2016 2015	
Foreign exchange forward contracts	\$(559)	\$(1,278)	\$(558)	\$(3,004)

Table of Contents

Note 8: Defined Benefit Pension Plans

We sponsor both funded and unfunded defined benefit pension plans for our international employees, primarily in Germany, France, Italy, Indonesia, Brazil, and Spain, offering death and disability, retirement, and special termination benefits. The defined benefit obligation is calculated annually by using the projected unit credit method. The measurement date for the pension plans was December 31, 2015.

Amounts recognized on the Consolidated Balance Sheets consist of:

	September 30, 2016 (in thousands)		December 31, 2015
Assets			
Plan assets in other long-term assets	\$ 609		\$ 359
Liabilities			
Current portion of pension benefit obligation in wages and benefits payable	2,581		3,493
Long-term portion of pension benefit obligation	86,310		85,971
Pension benefit obligation, net	\$ 88,282		\$ 89,105

Our asset investment strategy focuses on maintaining a portfolio using primarily insurance funds, which are accounted for as investments and measured at fair value, in order to achieve our long-term investment objectives on a risk adjusted basis. Our 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.

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

	Three Months Ended September 30, 2016 2015		Nine Months Ended September 30, 2016 2015	
	(in thousands)			
Service cost	\$1,003	\$904	\$2,930	\$3,162
Interest cost	649	595	1,932	1,820
Expected return on plan assets	(139)	(122)	(398)	(387)
Settlements and other	506	375	499	374
Amortization of actuarial net loss	330	488	991	1,470
Amortization of unrecognized prior service costs	16	14	47	43
Net periodic benefit cost	\$2,365	\$2,254	\$6,001	\$6,482

Table of Contents

Note 9: Stock-Based Compensation

We record stock-based compensation expense for awards of stock options, restricted stock units, unrestricted stock, and phantom stock units. We expense stock-based compensation primarily using the straight-line method over the requisite service period. Stock-based compensation expense and the related tax benefit were as follows:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
	2016	2015	2016	2015
	(in thousands)			
Stock options	\$602	\$713	\$1,741	\$2,005
Restricted stock units	4,595	1,969	10,834	8,374
Unrestricted stock awards	225	200	725	500
Phantom stock units	371	—	658	—
Total stock-based compensation	\$5,793	\$2,882	\$13,958	\$10,879
Related tax benefit	\$1,289	\$809	\$3,793	\$3,189

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

Subject to stock splits, dividends, and other similar events, 7,473,956 shares of common stock are reserved and authorized for issuance under our Amended and Restated 2010 Stock Incentive Plan (Stock Incentive Plan). Awards consist of stock options, restricted stock units, and unrestricted stock awards. At September 30, 2016, 2,111,769 shares were available for grant under the Stock Incentive Plan. The Stock Incentive Plan shares are subject to a fungible share provision such that the authorized share reserve is reduced by (i) one share for every one share subject to a stock option or share appreciation right granted under the Plan and (ii) 1.7 shares for every one share of common stock that was subject to an award other than an option or share appreciation right.

Stock Options

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

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

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Dividend yield ⁽¹⁾	—	%	—	%
Expected volatility ⁽¹⁾	33.7	%	33.5	%
Risk-free interest rate ⁽¹⁾	1.3	%	1.3	%

Expected term (years)⁽¹⁾ 5.5 — 5.5 5.5

⁽¹⁾ There were no employee stock options granted for the three months ended September 30, 2015.

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

Table of Contents

A summary of our stock option activity is as follows:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value ⁽¹⁾ (in thousands)	Weighted Average Grant Date Fair Value
Outstanding, January 1, 2015	1,123 (in thousands)	\$ 51.90	4.4	\$ 1,676	
Granted	207	35.30			\$ 12.15
Exercised	(23)	36.05		26	
Forfeited	(17)	37.47			
Expired	(167)	53.95			
Outstanding, September 30, 2015	1,123	\$ 49.12			