ITRON INC /WA/
Form 10-Q
November 04, 2008

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

FORM 10-Q

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from to

Commission file number 000-22418

ITRON, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

As of October 31, 2008, there were outstanding 34,474,211shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

Itron, Inc.

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements (Unaudited)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands, except per share data)			
Revenues	$ 484,818	$ 434,034	$ 1,477,225	$ 983,504
Cost of revenues	321,858	289,224	975,496	652,655
Gross profit	162,960	144,810	501,729	330,849
Operating expenses				
Sales and marketing	41,363	35,677	127,534	84,990
Product development	31,781	26,495	92,283	67,837
General and administrative	34,088	27,503	100,000	69,134
Amortization of intangible assets	30,395	25,864	93,114	58,127
In-process research and development	-	269	-	35,820
Total operating expenses	137,627	115,808	412,931	315,908
Operating income	25,333	29,002	88,798	14,941
Other income (expense)				
Interest income	1,962	585	4,846	8,890
Interest expense	(17,644)	(34,852)	(65,367)	(63,276)
Other income (expense), net	(281)	(873)	(1,938)	6,068
Total other income (expense)	(15,963)	(35,140)	(62,459)	(48,318)
Income (loss) before income taxes	9,370	(6,138)	26,339	(33,377)
Income tax (provision) benefit	(1,695)	2,692	(2,586)	13,231
Net income (loss)	$ 7,675	$ (3,446)	$ 23,753	$ (20,146)
Earnings (loss) per share				
Basic	$ 0.22	$ (0.11)	$ 0.73	$ (0.69)
Diluted	$ 0.21	$ (0.11)	$ 0.68	$ (0.69)
Weighted average number of shares outstanding				
Basic	34,385	30,415	32,632	29,239
Diluted	36,872	30,415	34,991	29,239

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

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

	September 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 147,391	$ 91,988
Accounts receivable, net	339,308	339,018
Inventories	188,224	169,238
Deferred income taxes, net	8,171	10,733
Other	60,627	42,459
Total current assets	743,721	653,436
Property, plant and equipment, net	317,598	323,003
Prepaid debt fees	14,142	21,616
Deferred income taxes, net	118,160	75,243
Other	16,474	15,235
Intangible assets, net	525,400	695,900
Goodwill	1,316,904	1,266,133
Total assets	$ 3,052,399	$ 3,050,566
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Trade payables	$ 217,754	$ 198,997
Accrued expenses	59,737	57,275
Wages and benefits payable	86,177	70,486
Taxes payable	24,071	17,493
Current portion of long-term debt	355,944	11,980
Current portion of warranty	25,911	21,277
Deferred income taxes, net	2,942	5,437
Unearned revenue	25,771	20,912
Total current liabilities	798,307	403,857
Long-term debt	848,917	1,578,561
Warranty	14,689	11,564
Pension plan benefits	61,869	60,623
Deferred income taxes, net	170,141	173,500
Other obligations	51,489	63,659
Total liabilities	1,945,412	2,291,764
Commitments and contingencies		
Shareholders' equity		
Preferred stock	-	-

Common stock	945,886	609,902
Accumulated other comprehensive income, net	115,116	126,668
Retained earnings	45,985	22,232
Total shareholders' equity	1,106,987	758,802
Total liabilities and shareholders' equity	$ 3,052,399	$ 3,050,566

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

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

	Nine Months Ended September 30, 2008	2007
	(in thousands)	
Operating activities		
Net income (loss)	$ 23,753	$ (20,146)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	133,295	85,329
In-process research and development	-	35,820
Employee stock plans income tax benefit	-	2,020
Stock-based compensation	12,560	8,998
Amortization of prepaid debt fees	7,665	12,034
Deferred income taxes, net	(27,473)	(47,418)
Other, net	236	(944)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	1,834	(15,231)
Inventories	(19,100)	2,801
Trade payables, accrued expenses and taxes payable	15,373	24,199
Wages and benefits payable	15,549	(6,510)
Unearned revenue	5,339	(8,390)
Warranty	103	764
Effect of foreign exchange rate changes	(2,214)	11,307
Other, net	(10,696)	5,021
Net cash provided by operating activities	156,224	89,654
Investing activities		
Proceeds from the maturities of investments, held to maturity	-	35,000
Acquisitions of property, plant and equipment	(41,422)	(30,173)
Business acquisitions, net of cash and cash equivalents acquired	(95)	(1,716,138)
Other, net	1,380	53
Net cash used in investing activities	(40,137)	(1,711,258)
Financing activities		
Proceeds from borrowings	-	1,159,027
Payments on debt	(384,426)	(37,278)
Issuance of common stock	323,424	243,146
Prepaid debt fees	(207)	(22,009)
Other, net	(44)	-
Net cash (used in) provided by financing activities	(61,253)	1,342,886
Effect of foreign exchange rate changes on cash and cash equivalents	569	2,448
Increase (decrease) in cash and cash equivalents	55,403	(276,270)
Cash and cash equivalents at beginning of period	91,988	361,405
Cash and cash equivalents at end of period	$ 147,391	$ 85,135

Non-cash transactions:				
Fixed assets purchased but not yet paid	$	5,282	$	2,277
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Income taxes	$	16,699	$	12,642
Interest, net of amounts capitalized		58,195		50,449

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
September 30, 2008
(UNAUDITED)

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

Note 1: Summary of Significant Accounting Policies

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

Financial Statement Preparation
The condensed consolidated financial statements presented in this Quarterly Report on Form 10-Q are unaudited and reflect entries necessary for the fair presentation of the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2008 and 2007, Condensed Consolidated Balance Sheets as of September 30, 2008 and December 31, 2007 and Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2008 and 2007 of Itron, Inc. and its subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature. Intercompany transactions and balances are eliminated upon consolidation.

Certain information and note disclosures normally included in financial statements prepared in accordance with 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 2007 audited financial statements and notes included in our Annual Report on Form 10-K, as filed with the SEC on February 26, 2008. The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

Basis of Consolidation
We consolidate all entities in which we have a greater than 50% ownership interest. We also consolidate entities in which we have a 50% or less investment and over which we have control. We use the equity method of accounting for entities in which we have a 50% or less investment and exercise significant influence. Entities in which we have less than a 20% investment and where we do not exercise significant influence are accounted for under the cost method. We consider for consolidation any variable interest entity of which we are the primary beneficiary. At September 30, 2008, we had no material investments in variable interest entities.

On April 18, 2007, we completed the acquisition of Actaris Metering Systems SA (Actaris), which is reported as our Actaris operating segment. The operating results of this acquisition are included in our condensed consolidated financial statements commencing on the date of the acquisition. At March 31, 2008, we completed allocations of the purchase price to the assets acquired and liabilities assumed.

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

Derivative Instruments
We account for derivative instruments and hedging activities in accordance with Statement of Financial Accounting Standards (SFAS) 133, Accounting for Derivative Instruments and Hedging Activities, as amended. All derivative

instruments, whether designated in hedging relationships or not, are recorded on the Condensed Consolidated Balance Sheets at fair value as either assets or liabilities. The components and fair values of our derivative instruments are determined using the fair value measurements of significant other observable inputs (Level 2), as defined by SFAS 157, Fair Value Measurements. We use observable market inputs based on the type of derivative and the nature of the underlying instrument. We also measure our counterparty credit risk based on current published credit default swap rates when determining the fair value of our derivatives. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded as a component of other comprehensive income and are recognized in earnings when the hedged item affects earnings. If the derivative is a net investment hedge, the effective portion of any unrealized gain or loss is reported in accumulated other comprehensive income as a net unrealized gain or loss on derivative instruments. Ineffective portions of fair value changes or derivative instruments that do not qualify for hedging activities are recognized in other income (expense) in the Condensed Consolidated Statement of Operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Condensed Consolidated Statements of Cash Flows. Derivatives are not used for trading or speculative purposes. Counterparties to our currency exchange and interest rate derivatives consist of major international financial institutions. We monitor our positions and include the credit risk of our counterparties when valuing our derivatives.

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Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

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

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally thirty years for buildings and three to five years for equipment, computers and furniture. Leasehold improvements are capitalized and amortized over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Costs related to internally developed software and software purchased for internal uses are capitalized in accordance with Statement of Position 98-1, Accounting for Costs of Computer Software Developed or Obtained for Internal Use, and are amortized over the estimated useful lives of the assets. Repair and maintenance costs are expensed as incurred. We have no major planned maintenance activities.

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset (or asset group as defined by SFAS 144, Accounting for the Impairment of Disposal of Long-Lived Assets) may not be recoverable. If there was an indication of impairment, management would prepare an estimate of future undiscounted cash flows expected to result from the use of the asset over its remaining economic life and its eventual disposition. If these cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value. There were no significant impairments of long-lived assets in the three and nine months ended September 30, 2008 and 2007. Assets held for sale are classified within other current assets in the Condensed Consolidated Balance Sheets and are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Prepaid Debt Fees

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

Business Combinations

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

Goodwill and Intangible Assets

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

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Warranty

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Beginning balance	$ 42,184	$ 36,190	$ 32,841	$ 18,148
Actaris acquisition opening balance/adjustments (1)	713	(57)	7,655	17,833
New product warranties	1,856	1,974	5,789	3,703
Other changes/adjustments to warranties	1,318	1,433	5,405	4,687
Claims activity	(3,908)	(3,786)	(11,424)	(8,663)
Effect of change in exchange rates	(1,563)	371	334	417
Ending balance	40,600	36,125	40,600	36,125
Less: current portion of warranty	(25,911)	(17,687)	(25,911)	(17,687)
Long-term warranty	$ 14,689	$ 18,438	$ 14,689	$ 18,438

(1) The acquisition adjustment for the three months ended September 30, 2008 reflects a reclassification from other liabilities.

Total warranty expense, which consists of new product warranties issued and other changes and adjustments to warranties, totaled approximately $3.2 million and $3.4 million for the three months ended September 30, 2008 and 2007, and approximately $11.2 million and $8.4 million for the nine months ended September 30, 2008 and 2007, respectively.

Health Benefits

We are self insured for a substantial portion of the cost of U.S. employee group health insurance. We purchase insurance from a third party, which provides individual and aggregate stop loss protection for these costs. Each reporting period, we expense the costs of our health insurance plan including paid claims, the change in the estimate of incurred but not reported (IBNR) claims, taxes and administrative fees (collectively the plan costs). Plan costs were approximately $4.8 million and $3.7 million for the three months ended September 30, 2008 and 2007, and $14.3 million and $11.6 million for the nine months ended September 30, 2008 and 2007, respectively. The IBNR accrual, which is included in wages and benefits payable, was $2.8 million and $2.1 million at September 30, 2008 and December 31, 2007, respectively. Our IBNR accrual and expenses can fluctuate due to the number of plan participants, claims activity and deductible limits. Our U.S. employees from the Actaris acquisition were transferred from a fully insured plan and added to our self-insured group health insurance at the beginning of 2008, resulting in

higher 2008 self-insurance expenses compared with 2007. For our employees located outside of the United States, health benefits are provided primarily through governmental social plans, which are funded through employee and employer tax withholdings.

Contingencies

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

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Bonus and Profit Sharing

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

Income Taxes

Income taxes are accounted for in accordance with SFAS No. 109, Accounting for Income Taxes. Under this method, deferred income taxes are recorded for the temporary differences between the financial reporting basis and tax basis of our assets and liabilities in each of the tax jurisdictions in which we operate. These deferred taxes are measured using the tax rates expected to be in effect when the temporary differences reverse. We establish a valuation allowance for a portion of the deferred tax asset when we believe it is more likely than not that a portion of the deferred tax asset will not be utilized. Deferred tax liabilities have not been recorded on undistributed earnings of international subsidiaries that are permanently reinvested.

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

Foreign Exchange

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

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Revenue Recognition

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

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

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

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

Product and Software Development Costs

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

Stock-Based Compensation

SFAS 123(R), Share-Based Payment, requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors, based on estimated fair values. We record stock-based compensation expenses under SFAS 123(R) for awards of stock options, our Employee Stock Purchase Plan (ESPP)

and issuance of restricted and unrestricted stock awards and units. The fair value of stock options and ESPP awards are estimated at the date of grant using the Black-Scholes option-pricing model, which includes assumptions for the dividend yield, expected volatility, risk-free interest rate and expected life. For restricted and unrestricted stock awards and units, the fair value is the market close price of our common stock on the date of grant. We expense stock-based compensation using the straight-line method over the requisite service period. A substantial portion of our stock-based compensation cannot be expensed for tax purposes. If we were to have tax deductions in excess of the compensation cost, they would be classified as financing cash inflows in the Condensed Consolidated Statements of Cash Flows.

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Fair Value Measurements

SFAS 157, Fair Value Measurements, became effective on January 1, 2008 and establishes a framework for measuring fair value, expands disclosures about fair value measurements of our financial assets and liabilities and specifies a hierarchy of valuation techniques based on whether the inputs used are observable or unobservable. The fair value hierarchy prioritizes the inputs used in different valuation methodologies, assigning the highest priority to unadjusted quoted prices for identical assets and liabilities in actively traded markets (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in non-active markets; and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means (inputs may include yield curves, volatility, credit risks and default rates). The disclosure requirements include the fair value measurement at the reporting date and the level within the fair value hierarchy in which the fair value measurements fall. For fair value measurements using Level 3 inputs, a reconciliation of the beginning and ending balances is required.

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

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

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

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

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

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Note 2: Earnings Per Share and Capital Structure

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands, except per share data)			
Net income (loss) available to common shareholders	$ 7,675	$ (3,446)	$ 23,753	$ (20,146)
Weighted average number of shares outstanding - Basic	34,385	30,415	32,632	29,239
Dilutive effect of stock-based awards and convertible notes	2,487	-	2,359	-
Weighted average number of shares outstanding - Diluted	36,872	30,415	34,991	29,239
Basic earnings (loss) per common share	$ 0.22	$ (0.11)	$ 0.73	$ (0.69)
Diluted earnings (loss) per common share	$ 0.21	$ (0.11)	$ 0.68	$ (0.69)

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. Weighted average common shares outstanding, assuming dilution, include the incremental shares that would be issued upon the assumed exercise of stock-based awards. At September 30, 2008 and 2007, we had stock-based awards outstanding of approximately 1.4 million and 1.6 million at weighted average option exercise prices of $51.26 and $36.56, respectively. The number of anti-dilutive stock-based awards excluded from the calculation of diluted EPS was 268,000 and 759,000 for the three months ended September 30, 2008 and 2007 and 178,000 and 785,000 for the nine months ended September 30, 2008 and 2007, respectively. These stock-based awards could be dilutive in future periods.

For our $345 million convertible notes, the dilutive effect is calculated under the net share settlement method in accordance with EITF 04-8, The Effect of Contingently Convertible Instruments on Diluted Earnings per Share. 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. Under the net share settlement method, if the average closing stock price for a quarter exceeds the conversion price of $65.15, we include the amount of shares it would take to satisfy the conversion obligation, assuming that all of the convertible notes are converted. The average closing price of our common stock for the three months ended September 30, 2008 exceeded the conversion price of $65.16 and therefore, approximately 1.7 million shares have been included in the calculation of diluted EPS. The number of shares calculated each quarter is included in the year-to-date calculation on a weighted-average basis. For the nine months ended September 30, 2008, approximately 1.6 million shares have been included in the diluted EPS calculation. For the three and nine months ended September 30, 2007, if we had net income and included the dilutive shares in the calculation of diluted EPS for those periods, approximately 1.2 million and 521,000 shares, respectively, would have been included.

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

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

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Note 3: Certain Balance Sheet Components

Accounts receivable, net		At September 30, 2008		At December 31, 2007
		(in thousands)		
Trade receivables (net of allowance of $6,304 and $6,391)	$	320,746	$	324,425
Unbilled revenue		18,562		14,593
Total accounts receivable, net	$	339,308	$	339,018

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2008		2007		2008		2007	
	(in thousands)							
Beginning balance	$	6,408	$	5,679	$	6,391	$	589
Actaris acquisition opening balance/adjustments		-		741		(471)		5,632
Provision for doubtful accounts		314		623		1,057		1,013
Accounts charged off		(105)		(231)		(661)		(390)
Effect of change in exchange rates		(313)		219		(12)		187
Ending balance, September 30	$	6,304	$	7,031	$	6,304	$	7,031

Inventories

A summary of the inventory balances is as follows:

		At September 30, 2008		At December 31, 2007
		(in thousands)		
Materials	$	95,078	$	81,636
Work in process		16,071		16,859
Finished goods		77,075		70,743
Total inventories	$	188,224	$	169,238

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

Property, plant and equipment, net		At September 30, 2008		At December 31, 2007
		(in thousands)		
Machinery and equipment	$	223,336	$	192,562
Computers and purchased software		70,630		66,412
Buildings, furniture and improvements		129,330		140,386
Land		38,503		41,750
Total cost		461,799		441,110
Accumulated depreciation		(144,201)		(118,107)
Property, plant and equipment, net	$	317,598	$	323,003

Depreciation expense was $13.5 million and $12.3 million for the three months ended September 30, 2008 and 2007, and $40.2 million and $27.2 million for the nine months ended September 30, 2008 and 2007, 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 September 30, 2008			At December 31, 2007		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	$ 401,827	$ (174,893)	$ 226,934	$ 403,665	$ (126,488)	$ 277,177
Customer contracts and relationships	310,101	(50,302)	259,799	312,709	(25,151)	287,558
Trademarks and trade names	78,267	(41,833)	36,434	154,760	(26,877)	127,883
Other	24,801	(22,568)	2,233	24,845	(21,563)	3,282
Total intangible assets	$ 814,996	$ (289,596)	$ 525,400	$ 895,979	$ (200,079)	$ 695,900

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)		(in thousands)	
Beginning balance, intangible assets, gross	$ 864,049	$ 775,073	$ 895,979	$ 231,868
Intangible assets acquired	-	76,135	-	623,242
Adjustment of previous acquisitions	-	-	(70,048)	(1,220)
Effect of change in exchange rates	(49,053)	31,526	(10,935)	28,844
Ending balance, intangible assets, gross	$ 814,996	$ 882,734	$ 814,996	$ 882,734

The intangible assets acquired in 2007 relate to the Actaris acquisition. During the first quarter of 2008, intangible assets were adjusted by $70.0 million for trademarks and trade names based on our completion of our fair value assessment associated with the Actaris acquisition. Intangible assets decreased by $1.2 million in the first nine months of 2007 due to an adjustment to intangible assets for the Flow Metrix acquisition based on the final determination of fair values of intangible assets acquired.

Intangible assets are recorded in the functional currency of our international subsidiaries; therefore, the carrying amount of intangible assets increase or decrease, with a corresponding change in accumulated other comprehensive income, due to changes in foreign currency exchange rates for those intangible assets owned by our international subsidiaries. Intangible asset amortization expense was $30.4 million and $25.9 million for the three months ended September 30, 2008 and 2007, and $93.1 million and $58.1 million for the nine months ended September 30, 2008 and 2007, respectively.

Estimated future annual amortization expense is as follows:

Years ending December 31,	Estimated Annual Amortization (in thousands)
2008 (from October 1, 2008)	$ 29,613
2009	102,406

2010		74,210
2011		63,522
2012		49,185
Beyond 2012		206,464
Total intangible assets, net	$	525,400

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Note 5: Goodwill

The following table reflects goodwill allocated to each reporting segment during the nine months ended September 30, 2008 and 2007, respectively.

	Itron North America	Actaris	Total Company
		(in thousands)	
Goodwill balance at January 1, 2007	$ 125,855	$ 411	$ 126,266
Goodwill acquired	-	1,043,821	1,043,821
Adjustment to previous acquisitions	980	-	980
Effect of change in exchange rates	1,853	45,458	47,311
Goodwill balance at September 30, 2007	$ 128,688	$ 1,089,690	$ 1,218,378
Goodwill balance at January 1, 2008	$ 128,329	$ 1,137,804	$ 1,266,133
Adjustment of previous acquisitions	-	55,370	55,370
Effect of change in exchange rates	(663)	(3,936)	(4,599)
Goodwill balance at September 30, 2008	$ 127,666	$ 1,189,238	$ 1,316,904

The increase during 2007 was due to the goodwill acquired in the Actaris acquisition on April 18, 2007. Goodwill was adjusted in 2008 and 2007 based on our final determination of certain fair values of assets acquired and the payment of additional consideration for our 2007 and 2006 acquisitions. Goodwill is recorded in the functional currency of our international subsidiaries; therefore, goodwill balances may increase or decrease, with a corresponding change in accumulated other comprehensive income, due to changes in foreign currency exchange rates.

On January 1, 2008, we consolidated certain operations between our two operating segments as a result of our continued integration of the Actaris acquisition. The allocation of goodwill to our reporting units is based on the new segment reporting structure and in accordance with SFAS 142, goodwill of $411,000 at January 1, 2007 has been reallocated between the segments to conform to the new segment reporting structure.

Note 6: Debt

The components of our borrowings are as follows:

	At September 30, 2008	At December 31, 2007
	(in thousands)	
Credit facility		
USD denominated term loan	$ 377,256	$ 596,793
EUR denominated term loan	372,443	445,228
GBP denominated term loan	-	79,091
Convertible senior subordinated notes	345,000	345,000
Senior subordinated notes	110,162	124,429
	1,204,861	1,590,541
Current portion of debt	(355,944)	(11,980)
Total long-term debt	$ 848,917	$ 1,578,561

Credit Facility

The Actaris acquisition in 2007 was financed in part by a $1.2 billion credit facility. The credit facility, dated April 18, 2007, was comprised of a $605.1 million first lien U.S. dollar denominated term loan; a €335 million first lien euro denominated term loan; a £50 million first lien pound sterling denominated term loan (collectively the term loans); and a $115 million multicurrency revolving line-of-credit (revolver). Our loan balances denominated in currencies other than the U.S. dollar fluctuate due to currency exchange rates. Interest rates on the credit facility are based on the respective borrowing's denominated London Inter Bank Offering Rate (LIBOR) or the Wells Fargo Bank, National Association's prime rate, plus an additional margin subject to factors including our consolidated leverage ratio. In accordance with our Credit Agreement, when our consolidated leverage ratio decreases below 4.5 times, the applicable margin decreases from 2.0% to 1.75%. On August 5, 2008, upon completion of our quarterly compliance certificate, our applicable margin decreased to 1.75%. Scheduled amortization of principal payments is 1% per year (0.25% quarterly) with an excess cash flow provision for additional annual principal repayment requirements. Maturities of the term loans and multicurrency revolver are seven years and six years from the date of issuance, respectively. Prepaid debt fees are amortized using the effective interest method through the term loans' earliest maturity date, as defined by the credit agreement. The credit facility is secured by substantially all of the assets of Itron, Inc., our operating subsidiaries, except our international subsidiaries, and contains 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. We were in compliance with these debt covenants at September 30, 2008. At September 30, 2008, there were no borrowings outstanding under the revolver and $49.1 million was utilized by outstanding standby letters of credit resulting in $65.9 million being available for additional borrowings.

We repaid $34.7 million in borrowings during the three months ended September 30, 2008 and $384.4 million in borrowings during the nine months ended September 30, 2008. These repayments were made with cash flows from operations and $311 million in net proceeds from the completed sale of 3.4 million shares of our common stock.

Senior Subordinated Notes

In May, 2004, we issued $125 million of 7.75% senior subordinated notes (subordinated notes) due in 2012, which were discounted to a price of 99.265 to yield 7.875%. The subordinated notes are registered with the SEC and are generally transferable. Fixed interest payments are required every six months, in May and November. The notes are subordinated to our credit facility (senior secured borrowings) and are guaranteed by all of our operating subsidiaries, except for our international subsidiaries. The subordinated notes contain covenants, which place restrictions on the incurrence of debt, the payment of dividends, certain investments and mergers. We were in compliance with these debt covenants at September 30, 2008. From time to time, we may reacquire a portion of the subordinated notes on the open market, resulting in the early extinguishment of debt. During 2008, we reacquired $14.4 million in principal amount of the subordinated notes. The balance of the subordinated notes, including accreted discount, was $110.2 million at September 30, 2008. Some or all of the subordinated notes may be redeemed at our option at any time on or after May 15, 2008 at a face value redemption price of 103.875% of the principal amount, decreasing to 101.938% on May 15, 2009 and 100.000% on May 15, 2010.

Convertible Senior Subordinated Notes

On August 4, 2006, we issued $345 million of 2.50% convertible notes due August 2026. Fixed interest payments of $4.3 million are required every six months, in February and August. 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 and events are met, 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 defined in EITF 05-2, The Meaning of "Conventional Convertible Debt Instruments" in Issue 00-19, 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 require bifurcation from the host contract in accordance with

SFAS 133, as the conversion feature is indexed to the Company's own stock and would be classified within stockholders' equity if it were a freestanding instrument as provided by EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.

The convertible notes contain purchase options, at the option of the holders, which may 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.

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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 (filed with the SEC on November 6, 2006 as Exhibit 4.16 our Quarterly Report on Form 10-Q):

- o during any fiscal quarter commencing after September 30, 2006, 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;
- o between July 1, 2011 and August 1, 2011, and any time after August 1, 2024;
- o 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 conversion value of the convertible notes;
- o if the convertible notes are called for redemption;
- o if a fundamental change occurs; or
- o upon the occurrence of defined corporate events.

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 principal amount will be less than the $1,000 principle amount and will be settled in cash.

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 notes are preserved. We may redeem some or all of the convertible notes for cash, on or after August 1, 2011, for a price equal to 100% of the principal amount plus accrued and unpaid interest.

The convertible notes are unsecured and subordinate to all of our existing and future senior secured borrowings. The convertible notes are unconditionally guaranteed, joint and severally, by all of our operating subsidiaries, except for our international subsidiaries, all of which are wholly 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 September 30, 2008.

At September 30, 2008, the contingent conversion threshold was exceeded as the closing sale price per share of our common stock on the NASDAQ Global Select Market exceeded $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 September 30, 2008. As a result, the notes are convertible at the option of the holder through the fourth quarter of 2008, and accordingly, the aggregate principal amount of the convertible notes at September 30, 2008 is included in the current portion of long-term debt. At December 31, 2007, the contingent conversion threshold was not exceeded and, therefore, the aggregate principal amount of the convertible notes is included in long-term debt. As our stock price is subject to fluctuation, the contingent conversion threshold may be exceeded during any quarter prior to July 2011, and the notes subject to conversion.

In May 2008, the FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion, addressing convertible instruments that may be settled in cash upon conversion (see Note 1, Summary of Significant Accounting Policies).

Prepaid Debt Fees & Interest Expense

Prepaid debt fees for our outstanding borrowings are amortized over the respective terms using the effective interest method. Total unamortized prepaid debt fees were approximately $14.1 million and $21.6 million at September 30, 2008 and December 31, 2007, respectively. Accrued interest expense was $4.5 million and $5.0 million at September 30, 2008 and December 31, 2007, respectively.

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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. Our objective is to offset gains and losses resulting from these exposures with losses and gains on the derivative contracts used to hedge them, thereby reducing the impact of volatility on earnings or protecting fair values of assets and liabilities.

On June 30, 2008, we entered into a one-year interest rate swap to convert $200 million of our USD term loan, which had a remaining balance of $377 million at September 30, 2008, under our Credit Agreement dated April 18, 2007, from a floating 1-month LIBOR interest rate to a fixed 3.01% interest rate. Our interest rate will continue to contain an additional margin per the credit facility agreement. 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, changes in the fair value of the interest rate swap are recorded as a component of other comprehensive income 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 was $200 million and the fair value, recorded as a short-term asset, was $349,000 at September 30, 2008. The amount of net gains expected to be reclassified into earnings through the remaining contract of nine months is approximately $1.9 million based on the Wells Fargo swap yield curve as of October 1, 2008.

In the third quarter of 2007, we entered into an interest rate swap to convert our €335 million euro denominated variable rate term loan to a fixed-rate debt obligation at a rate of 6.59% for the term of the debt, including expected prepayments. 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, changes in the fair value of the interest rate swap are recorded as a component of other comprehensive income 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 in accordance with scheduled prepayments. The notional amount of the swap was $372 million (€255 million) and the fair value, recorded as a long-term liability, was $113,000 at September 30, 2008. The amount of net gains expected to be reclassified into earnings in the next twelve months is approximately $2.5 million based on the Wells Fargo swap yield curve as of October 1, 2008.

In the second quarter of 2008, we began entering into certain foreign exchange forward contracts with the intent to reduce volatility of certain intercompany financing transactions. These contracts are not designated as accounting hedges and are de minimis in fair value and notional amounts.

In the second quarter of 2007, we designated certain portions of our foreign currency denominated term loans as hedges of our net investment in international operations. Net gains of $32 million ($20 million after-tax) were reported as a net unrealized gain on derivative instruments, a component of accumulated other comprehensive income, which represented effective hedges of net investments for the three months ended September 30, 2008. Net losses of $366,000 ($8,000 after-tax) were reported as a net unrealized loss on derivative instruments, a component of accumulated other comprehensive income, which represented effective hedges of net investments, for the nine months ended September 30, 2008. We had no hedge ineffectiveness.

In May 2008, we repaid the £50 million pound sterling denominated term loan. We realized a $208,000 loss in other income (expense) from the termination of the cross currency interest rate swap, which we entered into in the third quarter of 2007.

In April 2007, we completed the acquisition of Actaris and realized a $2.8 million gain in other income (expense) from the termination of the foreign currency range forward contracts. In the first quarter of 2007, we signed a stock purchase agreement to acquire Actaris and entered into foreign currency range forward contracts (transactions where put options were sold and call options were purchased) to reduce our exposure to declines in the value of the U.S.

dollar and pound sterling relative to the euro denominated purchase price. Under SFAS 133, the Actaris stock purchase agreement was considered an unrecognized firm commitment for a business acquisition; therefore, these foreign currency range forward contracts could not be designated as fair value hedges.

The components and fair values of our derivative instruments are determined using the fair value measurements of significant other observable inputs (Level 2), as defined by SFAS 157. We have used observable market inputs based on the type of derivative and the nature of the underlying instrument. The key inputs used at September 30, 2008 included interest rate yield curves, foreign exchange rates, the spot price of the underlying instrument and related volatility, all of which are considered to be available in an active market. The key inputs used at September 30, 2008 were considered Level 2 inputs. We have utilized the mid-market pricing convention for these inputs, which represents the mid-point of the observable rates in an active market at the reporting date. The fair values also included a measure of our counterparty credit risk based on current published credit default swap rates. We have one counterparty for our outstanding derivatives for which we have a master netting agreement. We believe the netting agreement reduces our counterparty credit exposure. At September 30, 2008, the net fair value of our derivatives was an asset of $222,000. We anticipate that our counterparty will be able to fully satisfy their obligations under our outstanding derivative contracts.

The fair values of our derivative instruments determined using the fair value measurement of significant other observable inputs (Level 2) are as follows:

		At September 30, 2008 (in thousands)
Other current assets: $200 million USD term loan interest rate swap	$	349
Accrued expenses: Foreign exchange forward contracts		(14)
Long-term other obligations: $372 million EUR term loan interest rate swap		(113)
Net fair value of derivative instruments valued using Level 2 inputs	$	222

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Note 8: Pension Plan Benefits

We sponsor both funded and unfunded non-U.S. defined benefit pension plans offering death and disability, retirement and special termination benefits to employees in Germany, France, Spain, Italy, Belgium, Chile, Portugal, Hungary and Indonesia. These plans were assumed with the acquisition of Actaris on April 18, 2007. Our general funding policy for these qualified pension plans is to contribute amounts at least sufficient to satisfy regulatory funding standards of the respective countries for each plan. For 2008, we expect to contribute a total of $500,000 to our defined benefit pension plans. Our expected contribution assumes that actual plan asset returns are consistent with our expected rate of return and that interest rates remain constant. For the three and nine months ended September 30, 2008, we contributed approximately $33,000 and $126,000, respectively, to the defined benefit pension plans.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	April 18, 2007 Through September 30,
	2008	2007	2008	2007
	(in thousands)			
Service cost	$ 438	$ 520	$ 1,616	$ 928
Interest cost	955	812	2,825	1,456
Expected return on plan assets	(78)	(60)	(230)	(107)
Settlements and curtailments	-	(134)	-	(227)
Amortization of actuarial net gain	(44)	-	(119)	-
Amortization of unrecognized prior service costs	13	-	44	-
Net periodic benefit cost	$ 1,284	$ 1,138	$ 4,136	$ 2,050

Note 9: Stock-Based Compensation

We record stock-based compensation expense under SFAS 123(R) for awards of stock options, our ESPP and issuance of restricted and unrestricted stock awards and units. We expense stock-based compensation using the straight-line method over the requisite service period. For the three months ended September 30, 2008 and 2007, stock-based compensation expense was $4.5 million and $3.1 million and the related tax benefit was $1.1 million and $809,000, respectively. For the nine months ended September 30, 2008 and 2007, stock-based compensation expense was $12.5 million and $9.0 million and the related tax benefit was $2.9 million and $2.2 million, respectively. We have capitalized no stock-based compensation expense. We issue new shares of common stock upon the exercise of stock options or when vesting conditions on restricted awards are fully satisfied. Cash received from the exercise of stock options and similar awards was $5.8 million and $7.9 million for the three months ended September 30, 2008 and 2007, and $12.4 million and $18.9 million for the nine months ended September 30, 2008 and 2007, respectively.

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 (1) Nine Months Ended September 30,	
	2008	2007
Dividend yield	-	-
Expected volatility	44.8%	38.4%
Risk-free interest rate	3.0%	4.6%

Expected life (years)	4.49	4.94

	ESPP			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Dividend yield	-	-	-	-
Expected volatility	36.8%	26.2%	52.6%	24.9%
Risk-free interest rate	1.9%	5.0%	2.2%	5.0%
Expected life (years)	0.25	0.25	0.25	0.25

(1)There were no Employee Stock Options granted for the three months ended September 30, 2008 and 2007.

For 2008 and 2007, expected price volatility is based on a combination of historical volatility of our common stock and the implied volatility of our traded options for the related vesting period. We believe this combined approach is reflective of current and historical market conditions and 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 remaining term equal to the expected life of the award. The expected life is the weighted average expected life for the entire award based on the fixed period of time between the date the award is granted and the date the award is fully exercised. Factors to be considered in estimating the expected life include historical experience of similar awards, with consideration to the contractual terms, vesting schedules and expectations of future employee behavior. We have not paid dividends in the past and do not plan to pay any dividends in the foreseeable future.

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Subject to stock splits, dividends and other similar events, 5,875,000 shares of common stock are reserved and authorized for issuance under our Amended and Restated 2000 Stock Incentive Plan, of which 534,201 shares remain available for issuance at September 30, 2008. In addition, of the authorized shares under the plan, no more than 1.0 million shares can be issued as non-stock options (awards). Awards consist of restricted stock units, restricted stock awards and unrestricted stock awards. Shares remaining for issuance as awards were 614,858 at September 30, 2008.

Stock Options

Stock options to purchase the Company's common stock are granted to employees and the Board of Directors with an exercise price equal to the fair market value of the stock on the date of grant upon approval by our Board of Directors. Options generally become exercisable in three or four equal installments beginning one year from the date of grant and generally expire 10 years from the date of grant.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. No stock options were granted during the three months ended September 30, 2008 and 2007. The weighted average grant date fair values of the stock options granted during the nine months ended September 30, 2008 and 2007 were $39.07 and $27.21 per share, respectively. Compensation expense related to stock options recognized under SFAS 123(R) for the three months ended September 30, 2008 and 2007 was $2.2 million and $2.4 million and $6.8 million and $7.2 million for the nine months ended September 30, 2008 and 2007, respectively. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on our historical experience and future expectations.

A summary of our stock option activity for the nine months ended September 30, 2008 and 2007 is as follows:

	Shares (in thousands)	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, January 1, 2007	2,225	$ 29.78	7.46	$ 49,469
Granted	200	66.94		
Exercised	(737)	23.76		
Forfeited	(50)	44.01		
Expired	(7)	42.62		
Outstanding, September 30, 2007	1,631	$ 36.56	7.29	$ 92,142
Exercisable and expected to vest, September 30, 2007	1,472	$ 35.18	7.14	$ 85,208
Exercisable, September 30, 2007	839	$ 24.18	5.98	$ 57,825
Outstanding, January 1, 2008	1,561	$ 37.81	6.98	$ 90,769
Granted	247	95.79		
Exercised	(399)	26.37		
Forfeited	(19)	46.71		
Outstanding, September 30, 2008	1,390	$ 51.26	7.25	$ 53,578
Exercisable and expected to vest, September 30, 2008	1,324	$ 49.90	7.16	$ 52,683

Exercisable, September 30, 2008	804	$ 34.88	6.12	$ 43,182

The aggregate intrinsic value in the table above is the amount by which the market value of the underlying stock exceeded the exercise price of the outstanding options before applicable income taxes, based on our closing stock price as of the last business day of the period, which represents amounts that would have been received by the optionees had all options been exercised on that date. As of September 30, 2008, total unrecognized stock-based compensation expense related to nonvested stock options, net of estimated forfeitures, was approximately $11.9 million, which is expected to be recognized over a weighted average period of approximately 21 months. During the three months ended September 30, 2008 and 2007, the total intrinsic value of stock options exercised was $12.9 million and $17.7 million, respectively. During the nine months ended September 30, 2008 and 2007, total intrinsic value of stock options exercised was $28.2 million and $37.1 million, respectively.

Restricted Stock Units

Certain employees and senior management receive Restricted Stock Units or Restricted Stock Awards (collectively "Restricted Awards") as a portion of their total compensation. The Restricted Awards issued under the Long-Term Performance Plan (LTPP) are contingent on the attainment of yearly goals. Generally, the Restricted Awards have a cliff vesting period in which employees become 100% vested three years from the anniversary of the grant date. Upon vesting, the Restricted Awards are converted into shares of the Company's common stock on a one-for-one basis and issued to employees. Compensation expense is generally recognized over the vesting period from the date of grant and is recognized only for those awards expected to vest, with forfeitures estimated based on our historical experience and future expectations. The fair value is the market close price of our common stock on the date of grant. The Company is entitled to an income tax deduction in an amount equal to the taxable income reported by the holder upon vesting of the Restricted Awards.

The maximum LTPP awards attainable for the 2008 performance period is 53,119 shares at a grant date fair value of $77.74 per share. The LTPP awards issued for the 2007 plan consisted of 21,392 shares at a grant date fair value of $62.52 per share.

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During the three and nine months ended September 30, 2008, we granted 10,250 and 192,250 Restricted Awards, respectively. During the three and nine months ended September 30, 2007, we granted 1,500 and 62,167 Restricted Awards, respectively. Total compensation expense recognized for the Restricted Awards was $2.0 million and $490,000 for the three months ended September 30, 2008 and 2007, and $5.1 million and $1.3 million for the nine months ended September 30, 2008 and 2007, respectively. As of September 30, 2008, unrecognized compensation expense, net of estimated forfeitures, was $16.2 million, which is expected to be recognized over a weighted average period of approximately 23 months. The aggregate intrinsic value of our Restricted Awards outstanding was $27.6 million and $10.0 million at September 30, 2008 and 2007, respectively.

The following table summarizes Restricted Award activity for the nine months ended September 30, 2008 and 2007:

	Number of Restricted Awards (in thousands)		Weighted-Average Grant Date Fair Value
Nonvested, January 1, 2007	47	$	59.16
Issued	62		
Vested	(1)		
Forfeited	(1)		
Nonvested, September 30, 2007	107	$	62.74
Nonvested, January 1, 2008	111	$	66.92
Issued	213		
Vested	-		
Forfeited	(12)		
Nonvested, September 30, 2008	312	$	80.71

Unrestricted Stock Awards

We issue unrestricted stock awards to our Board of Directors as part of the Board of Directors' compensation. Awards are fully vested at issuance and are expensed when issued. The fair value of unrestricted stock awards is the market close price of our common stock on the date of grant. During the three months ended September 30, 2008 and 2007, we issued a total of 1,184 and 1,728 shares of these awards with a weighted average grant date fair value of $100.74 and $78.00 per share, respectively. During the nine months ended September 30, 2008 and 2007, we issued a total of 2,744 and 4,938 shares of these awards with a weighted average grant date fair value of $97.94 and $61.61 per share, respectively. The expense related to these awards was $119,000 and $134,000 for the three months ended September 30, 2008 and 2007, and $269,000 and $304,000 for the nine months ended September 30, 2008 and 2007, respectively.

Employee Stock Purchase Plan

Eligible employees who have completed three months of service, work more than 20 hours each week and are employed more than five months in any calendar year are eligible to participate in our ESPP. Employees who own 5% or more of our common stock are not eligible to participate in the ESPP. Under the terms of the ESPP, eligible employees can choose payroll deductions each year of up to 10% of their regular cash compensation. Such deductions are applied toward the discounted purchase price of our common stock. The purchase price of the common stock is 85% of the fair market value of the stock at the end of each fiscal quarter. Under the ESPP, we sold 8,672 and 9,600 shares to employees in the three months ended September 30, 2008 and 2007, and 24,647 and 32,920 shares to employees in the nine months ended September 30, 2008 and 2007, respectively. The fair value of ESPP awards issued is estimated using the Black-Scholes option-pricing model. The weighted average fair value of the ESPP awards issued in the three months ended September 30, 2008 and 2007 was $16.20 and $12.24 per share and $15.94

and $9.78 per share for the nine months ended September 30, 2008 and 2007, respectively. The expense related to ESPP recognized under SFAS 123(R) for the three months ended September 30, 2008 and 2007 was $138,000 and $85,000, respectively. The expense related to ESPP recognized under SFAS 123(R) for the nine months ended September 30, 2008 and 2007 was $406,000 and $277,000, respectively. We had no unrecognized compensation cost at September 30, 2008 associated with the awards issued under the ESPP. There were approximately 317,000 shares of common stock available for future issuance under the ESPP at September 30, 2008.

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Note 10: Income Taxes

Our tax provision (benefit) as a percentage of income (loss) before tax typically differs from the federal statutory rate of 35%, and can vary from period to period, due to fluctuations in operating results, new or revised tax legislation and accounting pronouncements, changes in the level of business conducted in domestic and international jurisdictions, IPR&D, research credits, state income taxes and adjustments to valuation allowances, among other items.

Our tax provision (benefit) as a percentage of income (loss) before tax was 18% and 10% for the three and nine months ended September 30, 2008, compared with 44% and 40% for the same periods in 2007. Our tax provisions for the three and nine months ended September 30, 2008 are lower than those in 2007 as 2008 reflects a benefit associated with lower effective tax rates on international earnings. We made an election under Internal Revenue Code Section 338 with respect to the Actaris acquisition, which resulted in a reduced global effective tax rate. Additionally, our reduced international tax liability reflects the benefit of international interest expense deductions.

Unrecognized tax benefits in accordance with FIN 48 were $35.4 million and $34.8 million at September 30, 2008 and December 31, 2007, respectively. We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. During the three and nine months ended September 30, 2008, we recognized a benefit of $305,000 and expense of $725,000, respectively, in interest and penalties. At September 30, 2007, we had accrued approximately $7.9 million in interest and penalties, which was primarily the result of the acquisition of Actaris on April 18, 2007. At September 30, 2008 and December 31, 2007, accrued interest was $3.1 million and $2.7 million and accrued penalties were $1.4 million and $2.2 million, respectively. Unrecognized tax benefits that would affect our tax provision at September 30, 2008 and December 31, 2007 were $9.7 million and $8.4 million, respectively. At September 30, 2008, we expect to pay $4.8 million in income tax obligations related to FIN 48 over the next twelve months. We are not able to reasonably estimate the timing of future cash flows relating to the remaining balance.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 was signed into law, extending the research tax credit for qualified research expenses incurred throughout 2008 and 2009. In the fourth quarter of 2008, we expect to record approximately $2.5 million in federal and state research credits, which will reduce our tax provision.

Note 11: Commitments and Contingencies

Guarantees and Indemnifications
Under FASB Interpretation 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, we record a liability for certain types of guarantees and indemnifications for agreements entered into or amended subsequent to December 31, 2002. We had no such guarantees or indemnifications as of September 30, 2008 and December 31, 2007.

We are often required to obtain letters of credit or bonds in support of our obligations for customer contracts. These letters of credit or bonds typically provide a guarantee to the customer for future performance, which usually covers the installation phase of a contract and may on occasion cover the operations and maintenance phase of outsourcing contracts. In addition to the outstanding standby letters of credit of $49.1 million issued under our credit facility's $115 million multicurrency revolver, our Actaris operating segment has a total of $26.5 million of unsecured multicurrency revolving lines of credit with various financial institutions with total outstanding standby letters of credit of $5.9 million at September 30, 2008. Unsecured surety bonds in force were $12.7 million and $13.8 million at September 30, 2008 and December 31, 2007, respectively. In the event any such bonds or letters of credit are called, we would be obligated to reimburse the issuer of the letter of credit or bond; however, we do not believe that any currently outstanding bonds or letters of credit will be called.

We generally provide an indemnification related to the infringement of any patent, copyright, trademark or other intellectual property right on software or equipment within our sales contracts, which indemnifies the customer from and pays the resulting costs, damages and attorney's fees awarded against a customer with respect to such a claim provided that (a) the customer promptly notifies us in writing of the claim and (b) we have the sole control of the defense and all related settlement negotiations. The terms of the indemnification normally do not limit the maximum potential future payments. We also provide an indemnification for third party claims resulting from damages caused by the negligence or willful misconduct of our employees/agents in connection with the performance of certain contracts. The terms of the indemnification generally do not limit the maximum potential payments.

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Legal Matters

We are subject to various legal proceedings and claims of which the outcomes are subject to significant uncertainty. Our policy is to assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the liability required, if any, for these contingencies is made after an analysis of each known issue in accordance with SFAS 5, Accounting for Contingencies, and related pronouncements. In accordance with SFAS 5, a liability is recorded and charged to operating expense when we determine that a loss is probable and the amount can be reasonably estimated. Additionally, we disclose contingencies for which a material loss is reasonably possible, but not probable. Legal contingencies at September 30, 2008 were not material to our financial condition or results of operations.

PT Mecoindo is a joint venture in Indonesia between PT Berca and one of the Actaris subsidiaries. PT Berca is the minority shareholder in PT Mecoindo and has sued several Actaris subsidiaries and the successor in interest to another company previously owned by Schlumberger. PT Berca claims that it had preemptive rights in the joint venture and has sought to nullify the transaction in 2001 whereby Schlumberger transferred its ownership interest in PT Mecoindo to an Actaris subsidiary. The plaintiff also seeks to collect damages for the earnings it otherwise would have earned had its alleged preemptive rights been observed. The Indonesian courts have awarded 129.6 billion rupiahs ($13.8 million) in damages, plus accrued interest at 18% annually, against the defendants and have invalidated the 2001 transfer of the Mecoindo interest to a subsidiary of Actaris. All of the parties have appealed the matter and it is currently pending before the Indonesian Supreme Court. We intend to continue vigorously defending our interest. In addition, Actaris has notified Schlumberger that it will seek to have Schlumberger indemnify Actaris from any damages it may incur as a result of this claim. In any event, we do not believe that an adverse outcome is likely to have a material adverse impact to our financial condition or results of operations.

In March 2008, IP Co. LLC filed a complaint in the U.S. District Court for the Eastern District of Texas against Itron, Inc., CenterPoint Energy and Eaton Corp. alleging infringement of a patent owned by IP Co. LLC. The complaint alleges that one U.S. patent, concerning wireless mesh networking systems that optimize data sent across a general area, is being infringed by the defendants. The complaint seeks unspecified damages as well as injunctive relief. We believe these claims are without merit and we intend to vigorously defend our interests. In any event, we do not believe an adverse outcome is likely nor do we believe an adverse outcome will have a material adverse impact to our financial condition or results of operations.

Note 12: Other Comprehensive Income

Other comprehensive income (loss) is reflected as an increase (decrease) to shareholders' equity and is not reflected in our results of operations. Other comprehensive income (loss) during the reporting periods, net of tax, was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Net income (loss)	$ 7,675	$ (3,446)	$ 23,753	$ (20,146)
Foreign currency translation adjustment	(179,516)	94,543	(14,272)	88,791
Net unrealized gain (loss) on derivative instruments	28,764	(25,074)	7,260	(25,074)
Net hedging gains reclassified into net income	111	138	448	138
Pension plan benefits liability adjustment	-	-	(99)	-
	(142,966)	66,161	17,090	43,709

Other comprehensive (loss) income before income taxes								
Income tax benefit (provision)		14,127		9,204		(4,889)		8,646
Other comprehensive income (loss), net	$	(128,839)	$	75,365	$	12,201	$	52,355

Accumulated other comprehensive income, net of income taxes, was approximately $115.1 million and $126.7 million at September 30, 2008 and December 31, 2007, respectively, and consisted of the adjustments for foreign currency translation, the unrealized loss on our derivative instruments, the hedging gain and the pension liability adjustment as indicated above.

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Note 13: Segment Information

The Actaris operating segment consists primarily of the operations from the Actaris acquisition, which occurred on April 18, 2007, as well as other Itron operations not located in North America that are now included in the Actaris segment. The operations of the Actaris operating segment are primarily located in Europe, with approximately 5% of operations located in the United States and approximately 20% located throughout the rest of the world. The remainder of our operations, primarily located in the United States and Canada, has been combined into a single operating segment called Itron North America. As we continue to integrate the Actaris acquisition, certain refinements of our segments may occur. The operating segment information as set forth below is based on our current segment reporting structure. In accordance with SFAS 131, Disclosures about Segments of an Enterprise and Related Information, historical segment information has been restated from the segment information previously provided to conform to the segment reporting structure after the April 18, 2007 Actaris acquisition and our January 1, 2008 refinement.

We have three measures of segment performance: revenue, gross profit (margin) and operating income (margin). Intersegment revenues were minimal. Corporate operating expenses, interest income, interest expense, other income (expense) and income tax expense (benefit) are not allocated to the segments, nor included in the measure of segment profit or loss. Assets and liabilities are not used in our measurement of segment performance and, therefore, are not allocated to our segments. Substantially all depreciation expense is allocated to our segments.

Segment Products

Itron North America	Electronic electricity meters with and without automated meter reading (AMR); gas and water AMR modules; handheld, mobile and network AMR data collection technologies; advanced metering infrastructure (AMI) technologies; software, installation, implementation, consulting, maintenance support and other services.
Actaris	Electromechanical and electronic electricity meters; mechanical and ultrasonic water and heat meters; diaphragm, turbine and rotary gas meters; one-way and two-way electricity prepayment systems, including smart key, keypad and smart card; two-way gas prepayment systems using smart card; AMR and AMI data collection technologies; installation, implementation, maintenance support and other managed services.

Segment Information

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Revenues				
Itron North America	$ 160,096	$ 142,706	$ 474,956	$ 426,374
Actaris	324,722	291,328	1,002,269	557,130
Total Company	$ 484,818	$ 434,034	$ 1,477,225	$ 983,504
Gross margin				
Itron North America	$ 63,011	$ 58,746	$ 187,511	$ 179,668
Actaris	99,949	86,064	314,218	151,181
Total Company	$ 162,960	$ 144,810	$ 501,729	$ 330,849

Operating income (loss)				
Itron North America	$ 19,774	$ 17,244	$ 57,687	$ 50,718
Actaris	16,567	20,209	61,682	(12,019)
Corporate unallocated	(11,008)	(8,451)	(30,571)	(23,758)
Total Company	25,333	29,002	88,798	14,941
Total other income (expense)	(15,963)	(35,140)	(62,459)	(48,318)
Income (loss) before income taxes	$ 9,370	$ (6,138)	$ 26,339	$ (33,377)

No single customer represented more than 10% of total Company revenues for the three and nine months ended September 30, 2008. One customer accounted for 12% of Itron North America revenues for the nine months ended September 30, 2008. No single customer represented more than 10% of Itron North America revenues for the three months ended September 30, 2008. No single customer accounted for more than 10% of the Actaris operating segment revenues for the three and nine months ended September 30, 2008.

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No single customer represented more than 10% of total Company revenues or of operating segment revenues for the three and nine months ended September 30, 2007.

Revenues by region were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
		(in thousands)		
Revenues by region				
Europe	$ 232,979	$ 214,684	$ 722,415	$ 403,134
United States and Canada	161,262	148,856	488,298	433,751
Other	90,577	70,494	266,512	146,619
Total revenues	$ 484,818	$ 434,034	$ 1,477,225	$ 983,504

Note 14: Consolidating Financial Information

Our subordinated notes and convertible notes, issued by Itron, Inc. (the Issuer) are guaranteed by our U.S. domestic subsidiaries, which are 100% owned, and any future domestic subsidiaries. The guarantees are joint and several, full, complete and unconditional. There are currently no restrictions on the ability of the subsidiary guarantors to transfer funds to the parent company.

The Actaris acquisition on April 18, 2007, consisted primarily of international entities, which are considered non-guarantor subsidiaries of our subordinated notes and convertible notes.

Condensed Consolidating Statement of Operations
Three Months Ended September 30, 2008

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenues	$ 155,224	$ 18,639	$ 319,800	$ (8,845)	$ 484,818
Cost of revenues	94,151	15,366	221,186	(8,845)	321,858
Gross profit	61,073	3,273	98,614	-	162,960
Operating expenses					
Sales and marketing	13,541	2,464	25,358	-	41,363
Product development	18,724	920	12,137	-	31,781
General and administrative	14,618	754	18,716	-	34,088
Amortization of intangible assets	5,661	-	24,734	-	30,395
Total operating expenses	52,544	4,138	80,945	-	137,627
Operating income (loss)	8,529	(865)	17,669	-	25,333
Other income (expense)					
Interest income	31,529	(17)	1,720	(31,270)	1,962
Interest expense	(17,516)	(31)	(31,367)	31,270	(17,644)
Other income (expense), net	693	91	(1,065)	-	(281)
Total other income (expense)	14,706	43	(30,712)	-	(15,963)

Income (loss) before income taxes		23,235		(822)		(13,043)		-		9,370
Income tax (provision) benefit		(4,349)		1,356		1,298		-		(1,695)
Equity in losses of guarantor and non-guarantor subsidiaries, net		(11,211)		(19)		-		11,230		-
Net income (loss)	$	7,675	$	515	$	(11,745)	$	11,230	$	7,675

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Condensed Consolidating Statement of Operations
Three Months Ended September 30, 2007

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenues	$ 141,031	$ 15,081	$ 286,960	$ (9,038)	$ 434,034
Cost of revenues	84,674	12,045	201,492	(8,987)	289,224
Gross profit	56,357	3,036	85,468	(51)	144,810
Operating expenses					
Sales and marketing	11,715	1,738	22,224	-	35,677
Product development	16,844	591	9,111	(51)	26,495
General and administrative	12,798	998	13,707	-	27,503
Amortization of intangible assets	6,636	-	19,228	-	25,864
In-process research and development	-	-	269	-	269
Total operating expenses	47,993	3,327	64,539	(51)	115,808
Operating income (loss)	8,364	(291)	20,929	-	29,002
Other income (expense)					
Interest income	30,462	(34)	2,156	(31,999)	585
Interest expense	(32,648)	(3,276)	(30,927)	31,999	(34,852)
Other income (expense), net	1,640	(488)	(2,025)	-	(873)
Total other income (expense)	(546)	(3,798)	(30,796)	-	(35,140)
Income (loss) before income taxes	7,818	(4,089)	(9,867)	-	(6,138)
Income tax benefit (provision)	3,995	783	(2,086)	-	2,692
Equity in (losses) earnings of guarantor and non-guarantor subsidiaries, net	(15,259)	745	-	14,514	-
Net loss	$ (3,446)	$ (2,561)	$ (11,953)	$ 14,514	$ (3,446)

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Condensed Consolidating Statement of Operations
Nine Months Ended September 30, 2008

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenues	$ 459,504	$ 60,240	$ 985,562	$ (28,081)	$ 1,477,225
Cost of revenues	279,154	46,499	677,864	(28,021)	975,496
Gross profit	180,350	13,741	307,698	(60)	501,729
Operating expenses					
Sales and marketing	40,770	6,766	79,998	-	127,534
Product development	56,135	2,519	33,689	(60)	92,283
General and administrative	41,272	1,982	56,746	-	100,000
Amortization of intangible assets	16,987	-	76,127	-	93,114
Total operating expenses	155,164	11,267	246,560	(60)	412,931
Operating income	25,186	2,474	61,138	-	88,798
Otr income (expense)					
Interest income	94,417	14	3,896	(93,481)	4,846
Interest expense	(64,836)	(120)	(93,892)	93,481	(65,367)
Other income (expense), net	2,190	(733)	(3,395)	-	(1,938)
Total other income (expense)	31,771	(839)	(93,391)	-	(62,459)
Income (loss) before income taxes	56,957	1,635	(32,253)	-	26,339
Income tax (provision) benefit	(2,001)	1,600	(2,185)	-	(2,586)
Equity in (losses) earnings of guarantor and					
non-guarantor subsidiaries, net	(31,203)	534	-	30,669	-
Net income (loss)	$ 23,753	$ 3,769	$ (34,438)	$ 30,669	$ 23,753

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Condensed Consolidating Statement of Operations
Nine Months Ended September 30, 2007

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenues	$ 422,370	$ 29,616	$ 561,929	$ (30,411)	$ 983,504
Cost of revenues	249,668	23,301	409,939	(30,253)	652,655
Gross profit	172,702	6,315	151,990	(158)	330,849
Operating expenses					
Sales and marketing	37,427	3,187	44,376	-	84,990
Product development	49,997	1,031	16,957	(148)	67,837
General and administrative	39,733	1,806	27,595	-	69,134
Amortization of intangible assets	19,900	-	38,227	-	58,127
In-process research and development	-	-	35,820	-	35,820
Total operating expenses	147,057	6,024	162,975	(148)	315,908
Operating income (loss)	25,645	291	(10,985)	(10)	14,941
Other income (expense)					
Interest income	62,095	10	3,191	(56,406)	8,890
Interest expense	(59,361)	(5,522)	(54,809)	56,416	(63,276)
Other income (expense), net	9,468	(408)	(2,992)	-	6,068
Total other income (expense)	12,202	(5,920)	(54,610)	10	(48,318)
Income (loss) before income taxes	37,847	(5,629)	(65,595)	-	(33,377)
Income tax benefit	5,045	652	7,534	-	13,231
Equity in losses of guarantor and non-guarantor subsidiaries, net	(63,038)	(1,829)	-	64,867	-
Net loss	$ (20,146)	$ (6,806)	$ (58,061)	$ 64,867	$ (20,146)

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Condensed Consolidating Balance Sheet
September 30, 2008

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
ASSETS					
Current assets					
Cash and cash equivalents	$ 63,995	$ 5,752	$ 77,644	$ -	$ 147,391
Accounts receivable, net	86,540	9,301	243,467	-	339,308
Intercompany accounts receivable	12,558	573	5,210	(18,341)	-
Inventories	50,573	7,527	131,118	(994)	188,224
Deferred income taxes, net	(3,512)	4,580	7,103	-	8,171
Other	18,629	174	41,824	-	60,627
Intercompany other	3,874	15	6,313	(10,202)	-
Total current assets	232,657	27,922	512,679	(29,537)	743,721
Property, plant and equipment, net	94,556	12,372	210,670	-	317,598
Prepaid debt fees	14,142	-	-	-	14,142
Deferred income taxes, net	85,435	-	32,725	-	118,160
Other	2,516	113	13,845	-	16,474
Intangible assets, net	60,032	-	465,368	-	525,400
Goodwill	113,846	9,926	1,193,132	-	1,316,904
Investment in subsidiaries	98,532	72,031	(65,716)	(104,847)	-
Intercompany notes receivable	1,752,659	-	2,612	(1,755,271)	-
Total assets	$ 2,454,375	$ 122,364	$ 2,365,315	$ (1,889,655)	$ 3,052,399
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities					
Trade payables	$ 43,768	$ 5,975	$ 168,011	$ -	$ 217,754
Accrued expenses	7,406	189	52,142	-	59,737
Intercompany accounts payable	2,873	4,424	11,044	(18,341)	-
Wages and benefits payable	30,256	2,255	53,666	-	86,177
Taxes payable	1,448	528	22,095	-	24,071
Current portion of long-term debt	355,944	-	-	-	355,944
Current portion of warranty	9,208	149	16,554	-	25,911
Deferred income taxes, net	1	-	2,941	-	2,942
Short-term intercompany advances	4,999	4,693	510	(10,202)	-
Unearned revenue	20,170	269	5,332	-	25,771
Total current liabilities	476,073	18,482	332,295	(28,543)	798,307
Long-term debt	848,918	-	(1)	-	848,917
Warranty	11,191	124	3,374	-	14,689
Pension plan benefits	-	-	61,869	-	61,869
Intercompany notes payable	1,399	1,211	1,752,661	(1,755,271)	-
Deferred income taxes, net	1	(283)	170,423	-	170,141

Other obligations	9,806	36	41,647	-	51,489
Total liabilities	1,347,388	19,570	2,362,268	(1,783,814)	1,945,412
Shareholders' equity					
Preferred stock	-	-	-	-	-
Common stock	945,886	98,547	99,961	(198,508)	945,886
Accumulated other comprehensive income, net	115,116	6,396	12,397	(18,793)	115,116
Retained earnings (accumulated deficit)	45,985	(2,149)	(109,311)	111,460	45,985
Total shareholders' equity	1,106,987	102,794	3,047	(105,841)	1,106,987
Total liabilities and shareholders' equity	$ 2,454,375	$ 122,364	$ 2,365,315	$ (1,889,655)	$ 3,052,399

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Condensed Consolidating Balance Sheet
December 31, 2007

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
ASSETS					
Current assets					
Cash and cash equivalents	$ 27,937	$ 1,664	$ 62,387	$ -	$ 91,988
Accounts receivable, net	95,908	7,151	235,959	-	339,018
Intercompany accounts receivable	15,359	25	5,855	(21,239)	-
Inventories	50,049	6,584	113,804	(1,199)	169,238
Deferred income taxes, net	5,528	1,294	3,911	-	10,733
Other	13,322	17	29,120	-	42,459
Intercompany other	7,729	7,800	19,365	(34,894)	-
Total current assets	215,832	24,535	470,401	(57,332)	653,436
Property, plant and equipment, net	85,036	12,543	225,424	-	323,003
Prepaid debt fees	21,616	-	-	-	21,616
Deferred income taxes, net	85,963	1,275	(11,995)	-	75,243
Other	1,762	15	13,458	-	15,235
Intangible assets, net	77,017	-	618,883	-	695,900
Goodwill	113,846	10,001	1,142,286	-	1,266,133
Investment in subsidiaries	118,733	71,943	(66,192)	(124,484)	-
Intercompany notes receivable	1,764,792	3,282	8,656	(1,776,730)	-
Total assets	$ 2,484,597	$ 123,594	$ 2,400,921	$ (1,958,546)	$ 3,050,566
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities					
Trade payables	$ 39,701	$ 4,336	$ 154,960	$ -	$ 198,997
Accrued expenses	7,124	546	49,605	-	57,275
Intercompany accounts payable	4,258	1,842	15,139	(21,239)	-
Wages and benefits payable	17,419	1,750	51,317	-	70,486
Taxes payable	1,335	(158)	16,316	-	17,493
Current portion of long-term debt	11,980	-	-	-	11,980
Current portion of warranty	8,411	151	12,715	-	21,277
Deferred income taxes, net	-	-	5,437	-	5,437
Short-term intercompany advances	12,807	14,782	7,305	(34,894)	-
Unearned revenue	15,120	-	5,792	-	20,912
Total current liabilities	118,155	23,249	318,586	(56,133)	403,857
Long-term debt	1,578,563	-	(2)	-	1,578,561
Warranty	10,104	100	1,360	-	11,564
Pension plan benefits	1	-	60,622	-	60,623
Intercompany notes payable	1,474	7,153	1,768,103	(1,776,730)	-
Deferred income taxes, net	962	-	172,538	-	173,500

Other obligations	16,536	25	47,098	-	63,659
Total liabilities	1,725,795	30,527	2,368,305	(1,832,863)	2,291,764
Shareholders' equity					
Preferred stock	-	-	-	-	-
Common stock	609,902	90,437	97,021	(187,458)	609,902
Accumulated other comprehensive income, net	126,668	8,548	10,468	(19,016)	126,668
Retained earnings (accumulated deficit)	22,232	(5,918)	(74,873)	80,791	22,232
Total shareholders' equity	758,802	93,067	32,616	(125,683)	758,802
Total liabilities and shareholders' equity	$ 2,484,597	$ 123,594	$ 2,400,921	$ (1,958,546)	$ 3,050,566

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Condensed Consolidating Statement of Cash Flows
Nine Months Ended September 30, 2008

Parent