

ITRON INC /WA/
Form 10-K/A
September 13, 2007

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

FORM 10-K/A

Amendment No. 1

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

For the fiscal year ended December 31, 2006

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
(State of Incorporation)**

**91-1011792
(I.R.S. Employer Identification Number)**

**2111 N Molter Road, Liberty Lake, Washington 99019
(509) 924-9900**

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

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

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

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this

Form 10-K. "

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of June 30, 2006 (the last business day of the registrant's most recently completed second fiscal quarter), the aggregate market value of the shares of common stock held by non-affiliates of the registrant (based on the closing price for the common stock on the NASDAQ National Market on such date) was \$1,510,628,542.

As of January 31, 2007, there were outstanding 25,748,297 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

The information called for by Part III is incorporated by reference to the definitive Proxy Statement for the Annual Meeting of Shareholders of the Company to be held May 15, 2007.

EXPLANATORY NOTE

Amendment No. 1 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, which was originally filed with the Securities and Exchange Commission (SEC) on February 23, 2007, is being filed to restate previously omitted financial information from Item 8, Financial Statements and Supplementary Data, to include financial information pursuant to SEC Regulation S-X Rule 3-10, *Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered*.

In addition, we have updated Item 8, Financial Statements and Supplementary Data, to retrospectively adjust for a change in the composition of our reportable segments, which occurred in the second quarter of 2007, in connection with our acquisition of Actaris Metering Systems SA. We have not updated Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, for the change in our reportable segments as we believe the current disclosures includes more detailed information than would be required under our updated segment presentation.

The restated and updated information noted above has been reflected in Notes 17 and 18 to the consolidated financial statements. This restatement had no effect on the accompanying Consolidated Statements of Operations, Consolidated Balance Sheets, Consolidated Statements of Shareholders' Equity or Consolidated Statements of Cash Flows. Other items and disclosures included in this Form 10-K/A have not been updated for any events subsequent to the previously filed Annual Report on Form 10-K.

We have also included Item 9A, Controls and Procedures, and Item 15, Exhibits, Financial Statement Schedule.

1

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF MANAGEMENT

To the Board of Directors and Shareholders of Itron, Inc.

Management is responsible for the preparation of our consolidated financial statements and related information appearing in this Annual Report on Form 10-K/A. Management believes that the consolidated financial statements fairly reflect the form and substance of transactions and that the financial statements reasonably present our financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. Management has included in our financial statements amounts based on estimates and judgments that it believes are reasonable under the circumstances.

Management's explanation and interpretation of our overall operating results and financial position, with the basic financial statements presented, should be read in conjunction with the entire report. The notes to consolidated financial statements, an integral part of the basic financial statements, provide additional detailed financial information. Our Board of Directors has an Audit and Finance Committee composed of independent directors. The Committee meets regularly with financial management and Deloitte & Touche LLP to review internal control, auditing and financial reporting matters.

LeRoy D. Nosbaum
Chairman and Chief Executive Officer

Steven M. Helmbrecht
Sr. Vice President and Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Itron, Inc.
Liberty Lake, Washington

We have audited the accompanying consolidated balance sheets of Itron, Inc. and subsidiaries (the “Company”) as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Itron, Inc. and subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, effective January 1, 2006.

As discussed in Note 18 to the consolidated financial statements, the accompanying consolidated financial statements have been restated to include a previously omitted footnote disclosure.

As discussed in Note 17 to the consolidated financial statements, the disclosures in the accompanying consolidated financial statements have been retrospectively adjusted for a change in the composition of reportable segments.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company’s internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 2007 expressed an unqualified opinion on management’s assessment of the effectiveness of the Company’s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP
Seattle, Washington
February 22, 2007 (September 12, 2007, as to Notes 17 and 18)

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2006	2005	2004
	(in thousands, except per share data)		
Revenues			
Sales	\$ 593,990	\$ 503,270	\$ 346,543
Service	50,052	49,420	52,651
Total revenues	644,042	552,690	399,194
Cost of revenues			
Sales	349,210	291,445	198,131
Service	27,390	27,624	30,394
Total cost of revenues	376,600	319,069	228,525
Gross profit	267,442	233,621	170,669
Operating expenses			
Sales and marketing	63,587	56,642	45,279
Product development	58,774	47,077	44,379
General and administrative	52,213	44,428	35,490
Amortization of intangible assets	31,125	38,846	27,901
Restructurings	-	390	7,258
In-process research and development	-	-	6,400
Total operating expenses	205,699	187,383	166,707
Operating income	61,743	46,238	3,962
Other income (expense)			
Interest income	9,497	302	166
Interest expense	(17,785)	(18,944)	(13,145)
Other income (expense), net	(1,220)	(68)	(389)
Total other income (expense)	(9,508)	(18,710)	(13,368)
Income (loss) before income taxes	52,235	27,528	(9,406)
Income tax (provision) benefit	(18,476)	5,533	4,149
Net income (loss)	\$ 33,759	\$ 33,061	\$ (5,257)
Earnings per share			
Basic	\$ 1.33	\$ 1.41	\$ (0.25)
Diluted	\$ 1.28	\$ 1.33	\$ (0.25)
Weighted average number of shares outstanding			
Basic	25,414	23,394	20,922
Diluted	26,283	24,777	20,922

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

CONSOLIDATED BALANCE SHEETS

	At December 31,	
	2006	2005
	(in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 361,405	\$ 33,638
Short-term investments, held to maturity	34,583	-
Accounts receivable, net	109,924	104,428
Inventories	52,496	49,456
Deferred income taxes, net	20,916	23,194
Other	17,121	10,941
Total current assets	596,445	221,657
Property, plant and equipment, net	88,689	77,623
Intangible assets, net	112,682	123,293
Goodwill	126,266	116,032
Deferred income taxes, net	47,400	48,955
Other	17,040	11,324
Total assets	\$ 988,522	\$ 598,884
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued expenses	\$ 43,922	\$ 46,215
Wages and benefits payable	24,214	23,732
Current portion of debt	-	4,376
Current portion of warranty	7,999	8,497
Unearned revenue	27,449	22,758
Total current liabilities	103,584	105,578
Long-term debt	469,324	160,186
Project financing debt	-	2,367
Warranty	10,149	6,779
Contingent purchase price	5,879	-
Other obligations	8,604	6,440
Total liabilities	597,540	281,350
Commitments and contingencies		
Shareholders' equity		
Preferred stock, no par value, 10 million shares authorized, no shares issued or outstanding	-	-
Common stock, no par value, 75 million shares authorized, 25,675,237 and 24,869,201 shares issued and outstanding	351,018	312,046
Accumulated other comprehensive income, net	1,588	871
Retained earnings	38,376	4,617
Total shareholders' equity	390,982	317,534
Total liabilities and shareholders' equity	\$ 988,522	\$ 598,884

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Shares	Amount	Accumulated Other Comprehensive Income (Loss) (in thousands)	Retained Earnings (Accumulated Deficit)	Total
Balances at January 1, 2004	20,572	\$ 200,567	\$ (136)	\$ (23,187)	\$ 177,244
Net loss				(5,257)	(5,257)
Currency translation adjustment, net of income tax provision of \$770			1,090		1,090
Total comprehensive loss					(4,167)
Stock issues:					
Options exercised	632	6,555			6,555
Employee stock plans income tax benefits		2,594			2,594
Issuance of stock-based compensation awards	10	193			193
Employee stock purchase plan	116	2,011			2,011
Balances at December 31, 2004	21,330	\$ 211,920	\$ 954	\$ (28,444)	\$ 184,430
Net income				33,061	33,061
Currency translation adjustment, net of income tax benefit of \$248			(83)		(83)
Total comprehensive income					32,978
Stock issues:					
Issuance of common stock	1,725	59,588			59,588
Options exercised	1,746	23,803			23,803
Employee stock plans income tax benefits		15,146			15,146
Issuance of stock-based compensation awards	6	180			180
Employee stock purchase plan	62	1,409			1,409
Balances at December 31, 2005	24,869	\$ 312,046	\$ 871	\$ 4,617	\$ 317,534
Net income				33,759	33,759
Currency translation adjustment, net of income tax provision of \$494			717		717
Total comprehensive income					34,476
Stock issues:					
Options exercised	751	13,081			13,081
Employee stock plans income tax benefits		13,547			13,547
Issuance of stock-based compensation awards	7	292			292
Employee stock purchase plan	48	2,169			2,169
Stock-based compensation expense		9,397			9,397
Reclassification of liability associated with					

restricted stock awards upon adoption
of

SFAS 123(R)			486				486
Balances at December 31, 2006	25,675	\$	351,018	\$	1,588	\$	38,376 \$ 390,982

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2006	2005	2004
	(in thousands)		
Operating activities			
Net income (loss)	\$ 33,759	\$ 33,061	\$ (5,257)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	46,234	51,572	38,785
Employee stock plans income tax benefits	13,547	15,146	2,594
Excess tax benefits from stock-based compensation	(9,717)	-	-
Stock-based compensation	9,689	739	421
Amortization of prepaid debt fees	4,526	5,031	1,832
Deferred income taxes, net	1,624	(22,017)	(6,590)
Acquired in-process research and development	-	-	6,400
Other, net	828	2,278	1,347
Changes in operating assets and liabilities, net of acquisitions:			
Accounts receivable	(3,275)	(14,183)	15,277
Inventories	(1,599)	(3,997)	(3,600)
Accounts payable and accrued expenses	(8,278)	4,432	3,232
Wages and benefits payable	(1,774)	9,282	(1,383)
Unearned revenue	5,698	156	10,952
Warranty	2,872	3,831	(8,456)
Other long-term obligations	(486)	(511)	(994)
Other, net	1,125	(5,203)	(1,505)
Net cash provided by operating activities	94,773	79,617	53,055
Investing activities			
Purchases of investments, held to maturity	(204,995)	-	-
Proceeds from the maturities of investments, held to maturity	170,434	-	-
Acquisitions of property, plant and equipment	(31,739)	(31,973)	(12,788)
Business acquisitions, net of cash and cash equivalents acquired	(21,121)	-	(253,050)
Other, net	1,922	1,402	(1,263)
Net cash used in investing activities	(85,499)	(30,571)	(267,101)
Financing activities			
Proceeds from borrowings	345,000	14,800	309,081
Change in short-term borrowings, net	-	-	(10,000)
Payments on debt	(42,703)	(126,196)	(74,234)
Issuance of common stock	15,250	84,727	8,338
Excess tax benefits from stock-based compensation	9,717	-	-
Prepaid debt fees	(8,771)	(391)	(13,646)
Other, net	-	28	(109)
Net cash provided by (used in) financing activities	318,493	(27,032)	219,430
Increase in cash and cash equivalents	327,767	22,014	5,384
Cash and cash equivalents at beginning of year	33,638	11,624	6,240
Cash and cash equivalents at end of year	\$ 361,405	\$ 33,638	\$ 11,624

Non-cash transactions:

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Fixed assets purchased but not yet paid	\$	6,631	\$	4,400	\$	-
Non-cash affects of acquisitions (Note 5)		637		-		-
Reclassification of prepaid debt fees		-		-		485
Taxes on contingent purchase price paid for acquisition		-		-		113

Supplemental disclosure of cash flow information:

Cash paid during the year for:

Income taxes	\$	3,434	\$	1,281	\$	530
Interest (net of amount capitalized)		5,234		14,314		23,848

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In these consolidated financial statements, 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 solutions to gas, electric and water utilities worldwide to assist them in optimizing the delivery and use of energy and water. Our solutions include electric meters, handheld computers, mobile and fixed network automated meter reading (AMR), advanced metering infrastructure (AMI), water leak detection and related software and services. Additionally, we sell enterprise software to manage, analyze and forecast utility data.

Basis of Consolidation

The consolidated financial statements include the Consolidated Statements of Operations for the years ended December 31, 2006, 2005 and 2004, Consolidated Balance Sheets as of December 31, 2006 and 2005 and Consolidated Statements of Shareholders' Equity and Cash Flows for the years ended December 31, 2006, 2005 and 2004, of Itron and our wholly owned subsidiaries.

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 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. We are not the primary beneficiary of any variable interest entities.

On April 1, 2006, we completed the acquisition of Quantum Consulting, Inc., which is reported within our Software Solutions segment. On June 1, 2006, we completed the acquisition of ELO Sistemas e Tecnologia Ltda., located in Brazil, which is reported within our Electricity Metering segment. On November 21, 2006, we completed the acquisition of Flow Metrix, Inc., which is reported in our Meter Data Collection segment. On July 1, 2004, we completed the acquisition of our Electricity Metering business, which became our Electricity Metering segment. The operating results of these acquisitions are included in our consolidated financial statements commencing on the date of each acquisition (see Note 5).

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.

Short-term investments

Investment securities are classified into one of three categories: held to maturity, trading or available for sale. Debt securities that we have the intent and ability to hold to maturity are classified as held to maturity and are reported at amortized cost (including amortization of premium or accretion of discount). Investment purchases and sales are accounted for on a trade date basis. Market value at a period end is based upon quoted market prices for each security. Realized gains and losses are determined using the specific identification method and are included in earnings. Premiums and discounts are recognized in interest income using the effective interest method over the terms of the securities.

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. 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, including those costs required under Statement of Financial Accounting Standards 151, *Inventory Costs—an amendment of ARB 43, Chapter 4* (SFAS 151), which was effective for inventory costs incurred on or after January 1, 2006. SFAS 151 did not have a material effect on our financial statements. Service inventories consist primarily of subassemblies and components necessary to support post-sale maintenance. A large portion of our low-volume manufacturing and all of our domestic handheld meter reading unit repair services are provided by an outside vendor, Servatron. At December 31, 2005, we had a 30% equity interest in Servatron, which we redeemed in the first quarter of 2006 (see Note 8). Consigned inventory held by Servatron totaled \$2.9 million at December 31, 2006 and 2005.

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 over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Project management costs incurred in connection with installation and equipment used in outsourcing contracts are capitalized and depreciated using the straight-line method over the shorter of the useful life or the term of the contract. 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*. Repair and maintenance costs are expensed as incurred. We have no major planned maintenance activities.

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset may not be recoverable. There were no significant impairments in 2006 and 2004. During 2005, we wrote-off approximately \$1.9 million of internal software no longer in use. If there was an indication of impairment, management would prepare an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset 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. Assets held for sale are classified within other current assets in the 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 (see Note 4).

Prepaid Debt Fees

Prepaid debt fees represent the capitalized direct costs incurred related to the issuance of debt and are recorded in other noncurrent assets. These costs are amortized to interest expense over the lives of the respective borrowings using the effective interest method. Debt fees associated with convertible notes are amortized through the date of the earliest put or conversion option. When debt is repaid early, the portion of unamortized prepaid debt fees related to the early principal repayment is written-off and included in interest expense in the Consolidated Statements of Operations.

Acquisitions

In accordance with SFAS 141, *Business Combinations*, we record the results of operations 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 at the date of acquisition. The balance of the purchase price after fair value allocations represents goodwill. The excess of the fair value of the acquisition over the cost, resulting from contingent consideration, is recorded as a liability. Contingent payments subsequently made are then applied against the liability. Amounts allocated to in-process research and development (IPR&D) are expensed in the period of acquisition.

Goodwill and Intangible Assets

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

Warranty

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

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

	Year Ended December 31,	
	2006	2005
	(in thousands)	
Beginning balance, January 1	\$ 15,276	\$ 13,574
Electricity Metering acquisition adjustments	-	(2,128)
New product warranties	2,875	3,360
Other changes/adjustments to warranties	7,229	7,569
Claims activity	(7,232)	(7,099)
Ending balance, December 31	18,148	15,276
Less: current portion of warranty	7,999	8,497
Long-term warranty	\$ 10,149	\$ 6,779

Total warranty expense, which consists of new product warranties issued and other changes and adjustments to warranties, totaled approximately \$10.1 million, \$10.9 million and \$6.7 million for the three years ended December 31, 2006, 2005 and 2004, respectively. Warranty expense is classified within cost of sales.

Health Benefits

We are self insured for a substantial portion of the cost of 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 \$14.5 million, \$14.6 million and \$8.4 million for the years ended December 31, 2006, 2005 and 2004, respectively. The IBNR accrual, which is included in wages and benefits payable, was \$1.9 million and \$2.1 million at December 31, 2006 and 2005, respectively. Fluctuations in the IBNR accrual are the result of the number of plan participants, claims activity and deductible limits.

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 loss. Changes in these factors could materially affect our financial position, results of operations and cash flows.

Income Taxes

We account for income taxes using the asset and liability method. Under this method, deferred income taxes are recorded for the temporary differences between the financial reporting basis and tax basis of our assets and liabilities. 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 been recorded on undistributed earnings of foreign subsidiaries.

Foreign Exchange

Our consolidated financial statements are prepared in U.S. dollars. Assets and liabilities of foreign subsidiaries are denominated in foreign currencies and are translated to U.S. dollars at the exchange rates in effect on the balance sheet date. Revenues, costs of revenues and expenses for these subsidiaries are translated using a weighted average rate for the relevant reporting period. Translation adjustments resulting from this process are included, net of tax, in accumulated other comprehensive income (loss) in shareholders' equity. Gains and losses that arise from exchange rate fluctuations for balances that are not denominated in the local currency are included in the Consolidated Statements of Operations unless those balances arose from intercompany transactions deemed to be long-term in nature. Currency gains and losses for this exception are included, net of tax, in accumulated other comprehensive income (loss) in shareholders' equity.

Revenue Recognition

Sales consist of hardware, software license fees, custom software development, field and project management service and engineering, consulting, implementation, installation and professional service revenues. Service revenues include post-sale maintenance support and outsourcing services. Outsourcing services include installation, operation and maintenance of meter reading systems to provide meter information to a customer for billing and management purposes. Outsourcing services can be provided for systems we own, as well as those owned by our customers.

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 the 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 bill and collect and is not contingent upon the delivery/performance of additional items.

Revenues are recognized when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the sales price is fixed or determinable and (4) 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 can not be reliably estimated. Hardware and software post-sale maintenance support fees are recognized ratably over the life of the related service contract. Under outsourcing arrangements, revenue is recognized as services are provided. Certain consulting services are recognized as services are performed.

Unearned revenue is recorded for products or services that have not been provided but have been invoiced under contractual agreements or paid for by a customer, or when products or services have been provided but the criteria for revenue recognition have not been met. Shipping and handling costs billed to customers are recorded as revenue, with the associated cost charged to cost of sales.

Product and Software Development Costs

Product and software development costs primarily include payroll and third party contracting fees. For software we develop to be marketed or sold, financial accounting standards require 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.

Advertising

Advertising costs are expensed as incurred. Advertising expenses were \$1.2 million, \$1.5 million and \$1.8 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Earnings Per Share

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

Stock-Based Compensation

On January 1, 2006, we adopted SFAS 123(R), *Share-Based Payment*, which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors based on estimated fair values. SFAS 123(R) supersedes Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees*. In March 2005, the Securities Exchange Commission (SEC) issued Staff Accounting Bulletin 107 (SAB 107) relating to SFAS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

We adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our fiscal year 2006. Our consolidated financial statements for the year ended December 31, 2006, reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, our consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123(R).

We record stock-based compensation expense under SFAS 123(R) for awards of stock options, our Employee Stock Purchase Plan (ESPP) and issuance of restricted and unrestricted stock. We expense stock-based compensation using the straight-line method. For the year ended December 31, 2006, stock-based compensation expense was \$9.7 million, before a related income tax benefit of \$1.7 million. There was no stock-based compensation expense capitalized at December 31, 2006. Stock-based compensation expense of \$739,000 for the year ended December 31, 2005 was related to the issuance of unrestricted stock and ESPP that we recognized under previous accounting standards. There was no stock-based compensation expense related to employee stock options recognized during the year ended December 31, 2005.

The adoption of SFAS 123(R) resulted in incremental stock-based compensation expense and a corresponding decrease to pre-tax income of \$9.0 million for the year ended December 31, 2006. A substantial portion of our stock-based compensation can not be expensed for tax purposes. This resulted in a decrease to income after tax of \$7.6 million, or \$0.30 per basic and \$0.29 per diluted share for the year. Prior to the adoption of SFAS 123(R), we presented all tax benefits resulting from the exercise of stock options as operating cash inflows. Under SFAS 123(R), the benefits of tax deductions in excess of the compensation cost recognized are classified as financing cash inflows rather than operating cash inflows, on a prospective basis. Cash provided by operating activities decreased and cash provided by financing activities increased by \$9.7 million, respectively, related to excess tax benefits from stock awards exercised during the year ended December 31, 2006.

The following table shows the effect on net earnings and earnings per share, for the year ended December 31, 2005 and 2004, had compensation cost been recognized based upon the estimated fair value on the grant date of stock options and ESPP in accordance with SFAS 123, *Accounting for Stock-based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*. Disclosures for the year ended December 31, 2006 are not presented because the amounts are recognized in the consolidated financial statements.

Year Ended December 31,	
2005	2004
(in thousands, except per share data)	

Net income (loss)

As reported	\$	33,061	\$	(5,257)
Deduct: stock-based compensation, net of tax		(5,404)		(5,261)
Pro forma net income (loss)	\$	27,657	\$	(10,518)

Basic earnings per share

As reported	\$	1.41	\$	(0.25)
Pro forma	\$	1.18	\$	(0.50)

Diluted earnings per share

As reported	\$	1.33	\$	(0.25)
Pro forma	\$	1.12	\$	(0.50)

12

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The fair value of stock options and ESPP awards issued during the years ended December 31, 2006, 2005 and 2004 were estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Employee Stock Options			ESPP		
	Year Ended December 31,			Year Ended December 31,		
	2006	2005	2004	2006	2005	2004
Dividend yield	-	-	-	-	-	-
Expected volatility	43.1%	58.9%	71.7%	41.3%	46.1%	38.7%
Risk-free interest rate	4.8%	3.8%	4.0%	4.7%	3.1%	1.5%
Expected life (years)	4.6	3.4	4.5	0.25	0.25	0.25

For 2006, 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. Prior to the adoption of SFAS 123(R), expected stock price volatility was estimated using only historical volatility. We believe this combined approach is more reflective of current and historical market conditions and a better 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 are historical experience of similar awards, giving 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.

For restricted and unrestricted stock awards, the fair value is the market close price of our common stock on the date of grant.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (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. Because of various factors affecting future costs and operations, actual results could differ from estimates.

Reclassifications

Due to our adoption of SFAS 123(R) on January 1, 2006, certain amounts in the 2005 and 2004 Consolidated Statement of Cash Flows have been reclassified to conform with the 2006 presentation.

New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB 109* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and is effective for us commencing January 1, 2007. The cumulative effect of applying FIN 48 shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. Although we are continuing to evaluate the impact of FIN 48, based on our current analysis, we do not expect it to have a material impact on our financial statements.

In September 2006, the FASB issued SFAS 157, *Fair Value Instruments* (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, on a prospective basis. We are currently evaluating the impact of the adoption of SFAS 157 on our financial statements.

In September 2006, the SEC released SAB 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), regarding the process of quantifying financial statement misstatements, such as assessing both the carryover and reversing effects of prior year misstatements on the current year financial statements. SAB 108 is effective for years ending after November 15, 2006. The adoption of SAB 108 did not have a material impact on our financial statements.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. This statement permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected would be reported in net income. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of the adoption of SFAS 159 on our financial statements.

Note 2: Earnings Per Share and Capital Structure

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

	Year Ended December 31,		
	2006	2005	2004
	(in thousands, except per share data)		
Basic earnings per share:			
Net income (loss) available to common shareholders	\$ 33,759	\$ 33,061	\$ (5,257)
Weighted average number of shares outstanding	25,414	23,394	20,922
Basic	\$ 1.33	\$ 1.41	\$ (0.25)
Diluted earnings per share:			
Net income (loss) available to common shareholders	\$ 33,759	\$ 33,061	\$ (5,257)
Weighted average number of shares outstanding	25,414	23,394	20,922
Dilutive effect of stock-based awards	869	1,383	-
Adjusted weighted average number of shares outstanding	26,283	24,777	20,922
Diluted	\$ 1.28	\$ 1.33	\$ (0.25)

The dilutive effect of stock-based awards is calculated using the treasury stock method. Under this method, EPS is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise, future compensation cost associated with the stock award and the amount of excess tax benefits. Weighted average common shares outstanding, assuming dilution, include the incremental shares that would be issued upon the assumed exercise of stock-based awards. At December 31, 2006, 2005 and 2004, we had stock-based awards outstanding of approximately 2.2 million, 2.4 million and 3.9 million at weighted average option exercise prices of \$29.78, \$21.24 and \$15.24, respectively. Approximately 270,000, 15,000 and 2.4 million stock-based awards were excluded from the calculation of diluted EPS for the years ended December 31, 2006, 2005 and 2004, respectively, because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

In August 2006, we issued \$345 million of convertible notes that if converted in the future, would have a potentially dilutive effect on our stock (see Note 9). Under the indenture for the convertible notes, upon conversion we are required to settle the principal amount of the convertible notes in cash and may elect to settle the remaining conversion obligation (stock price in excess of conversion price) in cash, shares or a combination. The effect on diluted earnings per share is calculated under the net share settlement method in accordance with the FASB's Emerging Issues Task Force 04-8, *The Effect of Contingently Convertible Instruments on Diluted Earnings per Share*. Under the net share settlement method, we include the amount of shares it would take to satisfy the conversion obligation, assuming that all of the convertible notes are surrendered. The average closing price of our common stock for each of the periods presented is used as the basis for determining dilution. The average price of our common stock for the year ended December 31, 2006 did not exceed the conversion price of \$65.16 and therefore, did not have an effect on diluted earnings per share.

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 preferred stock at the time outstanding 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 December 31, 2006, 2005 and 2004.

Note 3: Short-term Investments, Held to Maturity

Our investments are classified as held to maturity, have original maturities of less than one year and consist of U.S. government and federal agencies. We have the intent and ability to hold these investments to maturity. The securities are reported at their amortized cost with premiums and discounts recognized in interest income using the effective interest method over the terms of the securities. Any impairment to the fair value of the securities is considered temporary due to the short-term nature of the investments, with recovery of fair value expected at maturity.

The amortized cost and fair value of our investments at December 31, 2006 were as follows:

	Amortized Cost	Gross Recognized Gains (in thousands)	Gross Recognized Losses	Fair Value
U.S. government and federal agencies	\$ 34,583	\$ 7	\$ -	\$ 34,590

Note 4: Certain Balance Sheet Components

Accounts receivable, net

	At December 31,	
	2006	2005
	(in thousands)	
Trade (net of allowance for doubtful accounts of \$589 and \$598)	\$ 100,162	\$ 96,106
Unbilled revenue	9,762	8,322
Total accounts receivable, net	\$ 109,924	\$ 104,428

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

	Year Ended December 31,	
	2006	2005
	(in thousands)	
Beginning balance, January 1	\$ 598	\$ 1,312
Electricity Metering adjustments	-	(164)
Provision (benefit) for doubtful accounts	52	(165)
Recoveries	-	-
Accounts charged off	(61)	(385)
Ending balance, December 31	\$ 589	\$ 598

Inventories

A summary of the inventory balances is as follows:

	At December 31,	
	2006	2005
	(in thousands)	
Materials	\$ 29,650	\$ 25,744
Work in process	5,220	5,832
Finished goods	16,433	16,241
Total manufacturing inventories	51,303	47,817
Service inventories	1,193	1,639
Total inventories	\$ 52,496	\$ 49,456

Other current assets

Assets held for sale are classified within other current assets and are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. During the first quarter of 2006, after the purchase of our new headquarters facility in Liberty Lake, Washington at the end of 2005, our previous headquarters facility in Spokane Valley was listed for sale. As a result, the net carrying value of the Spokane Valley facility totaling

approximately \$8.8 million was transferred from property, plant and equipment to other current assets. During 2006, we reduced the carrying value of the facility by \$680,000 to reflect fair value less costs to sell, which was recorded in general and administrative expenses. We expect to sell the building in 2007.

<i>Property, plant and equipment, net</i>	At December 31,	
	2006	2005
	(in thousands)	
Machinery and equipment	\$ 59,485	\$ 47,709
Equipment used in outsourcing	16,086	16,086
Computers and purchased software	40,368	34,736
Buildings, furniture and improvements	45,670	45,611
Land	2,482	4,217
Total cost	164,091	148,359
Accumulated depreciation	(75,402)	(70,736)
Property, plant and equipment, net	\$ 88,689	\$ 77,623

Depreciation expense was \$15.1 million, \$12.8 million and \$11.2 million for the years ended December 31, 2006, 2005 and 2004, respectively.

On December 30, 2005, we completed the purchase of a building in Liberty Lake, Washington, which became our corporate headquarters in the third quarter of 2006. For the year ended December 31, 2006, we invested approximately \$11.6 million in capital improvements related to our new corporate headquarters, including capitalized interest costs of \$900,000. These capital improvements were substantially complete at September 30, 2006.

Note 5: Business Combinations

Quantum Consulting, Inc.

On April 1, 2006, we completed the acquisition of Quantum Consulting, Inc. (Quantum), an energy consulting firm. The acquisition expands our consulting services related to energy efficiency, planning design and market research in our Software Solutions segment. The preliminary purchase price, including a working capital adjustment of \$96,000 and net of cash acquired of \$81,000, is summarized as follows (in thousands):

Cash consideration, net of cash acquired	\$ 4,015
Direct transaction costs	478
Total purchase price	\$ 4,493

Of the purchase price consideration, \$400,000 is retained in an escrow account for indemnifications made by Quantum. The amount in escrow will be released at predetermined intervals through April 2008. Additional contingent consideration of up to \$1.0 million will be paid to Quantum shareholders if certain defined financial targets are achieved in 2006, 2007 and 2008. These additional payments will increase the purchase price and goodwill at the time the financial targets are achieved. The 2006 financial target was not achieved; therefore, no additional consideration was required at December 31, 2006. An additional payment will also be made to Quantum shareholders, of up to \$1.0 million, if certain key individuals remain employees through March 2009. A substantial portion of the payment will be recognized as compensation expense over the retention period.

The following financial information reflects the allocation of the purchase price based on estimated fair values of assets and liabilities as of the date of acquisition. The excess of the purchase price over the fair value of net assets acquired has been recorded as goodwill.

	April 1, 2006	Useful Life
	Fair Value	(in months)
	(in thousands)	
Fair value of tangible net assets acquired	\$ 446	

Identified intangible assets - amortizable

Non-compete agreements	670	55
Contract backlog	360	38
Goodwill	3,017	
Total net assets acquired	\$ 4,493	

The values assigned to the identified intangible assets were estimated using the income approach. Under the income approach, the fair value reflects the present value of the projected cash flows that are expected to be generated. The intangible assets will be amortized over the estimated useful lives of the estimated discounted cash flows assumed in the valuation models. Goodwill and intangible assets were allocated to our Software Solutions segment in accordance with SFAS 142. For tax purposes, goodwill is not deductible as we acquired the stock of Quantum.

16

ELO Sistemas e Tecnologia Ltda.

On June 1, 2006, we completed the acquisition of ELO Sistemas e Tecnologia Ltda. (ELO) for an initial cash payment of approximately \$1.9 million and a working capital adjustment of \$102,000. Cash consideration also included the settlement of a \$637,000 payable from ELO to us for inventory purchased by ELO prior to the acquisition. Additional contingent consideration will be payable if certain financial targets are achieved over the next five years. The 2006 financial target was not achieved; therefore, no additional consideration was required at December 31, 2006. Operations reside in Campinas, Brazil and include sales, manufacturing, service and maintenance, consulting and administrative functions related to meters, AMR technology and related systems in South America. The preliminary purchase price, which includes direct transaction costs and is net of cash acquired of \$10,000, is summarized as follows (in thousands):

Cash consideration, net of cash acquired	\$	2,641
Direct transaction costs		1,210
Total purchase price	\$	3,851

The purchase price was allocated to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values as of the date of acquisition. The estimated fair value of the net assets acquired and liabilities assumed exceeded the initial cash consideration paid by approximately \$5.5 million, resulting in negative goodwill. In a business combination with contingent consideration, the lesser of the maximum amount of contingent consideration or the total amount of negative goodwill should be recorded as a liability. As the purchase agreement does not limit the maximum contingent consideration payable, the full amount of the negative goodwill is reflected as a long-term liability. If contingent payments are made, we will apply the payments against the contingent liability. Payments in excess of the contingent liability balance, if any, will be recorded as goodwill.

The following financial information reflects a preliminary allocation of the purchase price based on estimated fair values of assets and liabilities as of the date of acquisition. We are continuing to assess certain assets acquired, including fixed assets, and expect to finalize the adjustments in the first quarter of 2007.

	June 1, 2006	Useful Life
	Fair Value	(in months)
	(in thousands)	
Fair value of tangible net assets acquired	\$ 682	
Identified intangible assets - amortizable		
Customer relationships/contracts	6,957	175
Contract backlog	1,731	12
Contingent purchase price liability	(5,519)	
Total net assets acquired	\$ 3,851	

The values assigned to the identified intangible assets were estimated using the income approach. Under the income approach, the fair value reflects the present value of the projected cash flows that are expected to be generated. The intangible assets will be amortized over the estimated useful lives of the estimated discounted cash flows assumed in the valuation models. Goodwill and intangible assets were allocated to our Electricity Metering segment in accordance with SFAS 142. Due to changes in foreign currency exchange rates, the contingent purchase price liability can increase or decrease, with a corresponding change in accumulated other comprehensive income (loss). The contingent purchase price liability was approximately \$5.9 million at December 31, 2006. This acquisition was structured such that we received an increase in basis for tax purposes equal to the cash consideration paid. In future years, intangible assets and goodwill will be recognized (and deductible) for tax purposes as contingent consideration payments are made.

Flow Metrix, Inc.

On November 21, 2006, we completed the acquisition of Flow Metrix, Inc. (Flow Metrix). Flow Metrix develops and manufactures advanced leak detection systems for underground pipelines, which will complement our fixed network water products and allow our customers to improve pipeline integrity management. The preliminary purchase price, which includes direct transaction costs, net of cash acquired of \$2.0 million, is summarized as follows (in thousands):

Cash consideration, net of cash acquired	\$	12,952
Direct transaction costs		654
Total purchase price	\$	13,606

17

Of the purchase price consideration, \$2.8 million was retained in an escrow account for working capital adjustments and indemnifications made by Flow Metrix. Additional consideration of up to \$3.0 million may be made if certain technological and integration milestones are achieved within the first three years. These additional payments will increase the purchase price and goodwill at the time the milestones are achieved. The agreement also provides us a one year option to purchase additional technology targeted at energy pipeline integrity for an additional payment of \$1.5 million.

The following information reflects a preliminary allocation of the purchase price based on estimated fair values of assets and liabilities as of the date of the acquisition. We are performing a review of the assets acquired and liabilities assumed, including intangible assets and the associated lives, and expect to finalize the majority of the fair value adjustments during the first quarter of 2007.

	November 21, 2006	
	Fair Value	Useful Life
	(in thousands)	(in months)
Fair value of net liabilities assumed	\$ (3,824)	
Identified intangible assets - amortizable		
Core-developed technology	8,600	120
Customer contracts	740	120
Tradenames	500	120
Other	430	12
Goodwill	7,160	
Total net assets acquired	\$ 13,606	

The values assigned to the identified intangible assets were estimated using the income approach. Under the income approach, the fair value reflects the present value of the projected cash flows that are expected to be generated. The intangible assets will be amortized over the estimated useful lives of the estimated discounted cash flows assumed in the valuation models. Goodwill and intangible assets were allocated to our Meter Data Collection segment in accordance with SFAS 142. For tax purposes, goodwill is not deductible as we acquired the stock of Flow Metrix.

Pro forma results are not presented for the acquisitions of Quantum, ELO and Flow Metrix because they were not considered material business combinations in accordance with SFAS 141.

Electricity Metering

On July 1, 2004, we completed the acquisition of our Electricity Meter business. This acquisition added electricity meter manufacturing and sales to our operations, creating our Electricity Metering operating segment.

The purchase price was \$248.3 million, which included a post closing working capital adjustment of \$109,000, less cash acquired of approximately \$1.4 million. Direct transaction costs were \$8.0 million. We used proceeds from a new \$240 million senior secured credit facility (credit facility) and a private placement of \$125 million in senior subordinated notes to finance the acquisition, pay related fees and expenses and repay approximately \$50.2 million of a previous credit facility.

The excess of the purchase price over the fair value of net assets acquired was recorded as goodwill. Goodwill and intangible assets were allocated to our new Hardware Solutions—Electricity Metering segment in accordance with SFAS 142.

The following financial information reflects the allocation of the purchase price based on final fair values of the assets and liabilities.

	Fair Value (in thousands)	Useful Life (in months)
Fair value of tangible net assets acquired	\$ 58,747	
In-process research and development	6,400	
Identified intangible assets - amortizable		
Core-developed technology	136,900	54 to 168
Contract backlog	1,800	6
Customer relationships/contracts	3,100	18
Trademarks and tradenames	25,200	90
Other	53	120
Goodwill	24,093	
Net assets acquired	\$ 256,293	

The values assigned to the identified intangible assets were estimated using the income approach. Under the income approach, the fair value reflects the present value of the projected cash flows that are expected to be generated. The intangible assets are being amortized over the estimated useful lives of the estimated discounted cash flows assumed in the valuation models. This acquisition was treated as an asset purchase for tax purposes; accordingly, goodwill and IPR&D expense are deductible for tax purposes over 15 years.

The \$6.4 million of IPR&D consisted primarily of next generation technology, valued at \$5.7 million. The IPR&D projects were analyzed according to exclusivity, substance, economic benefit, incompleteness, measurability and alternative future use. The primary projects were intended to make key enhancements and improve functionality of our polyphase meter. We valued IPR&D using the income approach, which uses the present value of the projected cash flows that are expected to be generated. The risk adjusted discount rate was 18 percent, which was based on several factors such as the industry composite of weighted average cost of capital, weighted average return on assets, internal rate of return and perceived risk of the projects. We originally estimated the research and development to be approximately 50% complete, with a cost to complete the development of approximately \$1.2 million over the next twelve months. At December 31, 2005, after incurring approximately \$1.3 million in costs, we were substantially complete with the in-process technology. Sales of this new technology took place in 2006.

Note 6: Identified Intangible Assets

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

	At December 31, 2006			At December 31, 2005		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	\$ 162,930	\$ (77,783)	\$ 85,147	\$ 154,330	\$ (54,064)	\$ 100,266
Patents	7,088	(5,059)	2,029	7,088	(4,690)	2,398
Capitalized software	5,065	(5,065)	-	5,065	(5,065)	-
Distribution and production rights	3,935	(3,384)	551	3,935	(3,220)	715
Customer contracts	16,888	(7,931)	8,957	8,750	(7,028)	1,722
Trademarks and tradenames	26,210	(12,022)	14,188	25,710	(7,634)	18,076
Other	9,752	(7,942)	1,810	6,450	(6,334)	116
Total identified intangible assets	\$ 231,868	\$ (119,186)	\$ 112,682	\$ 211,328	\$ (88,035)	\$ 123,293

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

	At December 31,	
	2006	2005
	(in thousands)	
Beginning balance	\$ 211,328	\$ 211,328
Intangible assets acquired	19,988	-
Effect of change in exchange rates	552	-
Ending balance, total intangible assets, gross	\$ 231,868	\$ 211,328

Increases in identified intangible assets were the result of the Quantum, ELO and Flow Metrix acquisitions during 2006. The carrying amount of intangible assets can also increase or decrease, with a corresponding change in

accumulated other comprehensive income (loss), due to changes in foreign currency exchange rates for those intangible assets owned by our foreign subsidiaries. At December 31, 2006, the intangible assets associated with the ELO acquisition increased \$552,000 as a result of a change in foreign currency rates. Intangible asset amortization expense was \$31.1 million in 2006, \$38.8 million in 2005 and \$27.6 million in 2004.

Estimated future annual amortization expense is as follows:

Years ending December 31,	Estimated Annual Amortization (in thousands)
2007	\$ 28,146
2008	23,742
2009	19,991
2010	14,010
2011	11,764
Beyond 2011	15,029
Total identified intangible assets, net	\$ 112,682

19

Note 7: Goodwill

We test goodwill for impairment as of October 1 of each year. No impairment adjustment was required in 2006, 2005 or 2004. On April 1, 2006, we completed the acquisition of Quantum and recorded a preliminary allocation of the purchase price, resulting in \$3.0 million of estimated goodwill. On November 21, 2006, we completed the acquisition of Flow Metrix and recorded a preliminary allocation of the purchase price, resulting in \$7.2 million of estimated goodwill. On July 1, 2004, we completed the acquisition of our Electricity Metering business and continued to make adjustments to the purchase price through June 2005 as the valuation of assets and liabilities were finalized. Goodwill decreased in 2005 primarily due to a \$2.1 million adjustment related to a warranty accrual associated with the Electricity Metering acquisition. Goodwill balances can also increase or decrease, with a corresponding change in accumulated other comprehensive income (loss), due to changes in foreign currency exchange rates.

The following table reflects goodwill allocated to each reporting segment at December 31, 2006 and 2005.

	Hardware Solutions			Total Company
	Electricity Metering	Meter Data Collection	Software Solutions	
	(in thousands)			
Goodwill balance at December 31, 2004	\$ 26,236	\$ 73,337	\$ 17,898	\$ 117,471
Goodwill adjustments	(1,758)	-	-	(1,758)
Effect of change in exchange rates	77	195	47	319
Goodwill balance at December 31, 2005	24,555	73,532	17,945	116,032
Goodwill acquired	-	7,160	3,017	10,177
Effect of change in exchange rates	54	2	1	57
Goodwill balance at December 31, 2006	\$ 24,609	\$ 80,694	\$ 20,963	\$ 126,266

Note 8: Investments in Affiliates and Related Party Transactions*Investments in Affiliates*

During 2006, our 30% equity interest in Servatron was redeemed for \$1.0 million and we recognized a loss of \$242,000. Servatron serves both as a contract manufacturer for our low volume products and as our handheld service repair depot. Prior to our stock redemption, we received a dividend of \$193,000, which was recorded as a return on investment. Therefore, at December 31, 2006, we had no ownership in Servatron. At December 31, 2005, this investment, accounted for under the equity method of accounting, was \$1.4 million. Our equity in earnings, recorded in other income (expense) was \$33,000 and \$82,000 for the years ended December 31, 2006 and 2005. There were no earnings or losses in the year ended December 31, 2004. Purchases of low volume products and repair services from Servatron were \$17.0 million in 2006, \$19.3 million in 2005 and \$12.7 million in 2004, with amounts payable to Servatron of \$605,000 and \$1.5 million at December 31, 2006 and 2005, respectively. We continue to lease to Servatron a portion of our Spokane Valley facility, which is currently held for sale (see Note 4). Lease revenues were approximately \$186,000 in both 2006 and 2005 and approximately \$181,000 in 2004. Servatron also remits payment for consigned inventory purchased from us. Accounts receivable was approximately \$445,000 and \$360,000 at December 31, 2006 and 2005, respectively.

During 2005, we established a limited liability company with an entity in Qatar, a Middle East country, to open a sales and distribution office in Qatar. We invested \$27,000, acquiring a 49% ownership. Although this ownership is less

than 50%, we maintain decision-making and control; therefore requiring consolidation of the subsidiary and its operations. At December 31, 2006 and 2005, the balance for the non-controlling interest portion of the investment was zero because cumulative operating losses exceeded the total invested capital. Losses are recorded to other income (expense).

During the first quarter of 2006, our Chief Financial Officer became a board member of a financial institution, which is a 3.6% participant in our \$55 million revolver. Fees paid to this financial institution during 2006, associated with our revolver, were minimal.

We lease a facility from former owners of a business we acquired in 2002, one of whom is a current employee. The lease agreement was renewed in March 2004 and will terminate in February 2008. The monthly lease expense is approximately \$40,000. We also lease a facility from a current employee, with monthly lease expense of approximately \$5,000. This lease was renewed in August 2006 and will terminate in August 2009.

20

Note 9: Debt

The components of our borrowings are as follows:

	At December 31,	
	2006	2005
	(in thousands)	
Senior subordinated notes	\$ 124,324	\$ 124,226
Convertible senior subordinated notes	345,000	-
Senior secured credit facility term loan	-	24,676
Real estate term note	-	14,800
Project financing debt	-	3,227
	469,324	166,929
Current portion of debt	-	(4,376)
Total long-term debt	\$ 469,324	\$ 162,553

Senior Subordinated Notes

Our senior subordinated notes (subordinated notes) consist of \$125 million aggregate principal amount of 7.75% notes, issued in May 2004 and due in 2012. The subordinated notes were discounted to a price of 99.265 to yield 7.875%, with a balance of \$124.3 million at December 31, 2006. The subordinated notes are registered with the SEC and are generally transferable. The discount on the subordinated notes is accreted and the prepaid debt fees are amortized over the life of the notes. Fixed interest payments of \$4.8 million are required every six months, in May and November. The notes are subordinated to our credit facility and are guaranteed by all of our operating subsidiaries, except for our foreign subsidiaries, all of which are wholly owned. As of December 31, 2006, all guarantor operating subsidiaries were merged into Itron parent. 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 December 31, 2006 and 2005. Some or all of the subordinated notes may be redeemed at our option at any time on or after May 15, 2008, at their principal amount plus a specified premium. At any time prior to May 15, 2007, we may, at our option, redeem up to 35% of the subordinated notes at 107.75%, with the proceeds of certain sales of our common stock.

Convertible Senior Subordinated Notes

On August 4, 2006, we issued \$345 million of 2.50% convertible senior subordinated notes (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 Emerging Issues Task Force (EITF) 05-02, *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, *Accounting for Derivative Instruments and Hedging Activities (as amended)*, 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 may be converted under the following circumstances, at the option of the holder, at an initial conversion rate of 15.3478 shares of our common stock for each \$1,000 principal amount of the convertible notes (conversion price of \$65.16 per share), as defined in the indenture:

- o during any fiscal quarter commencing after September 30, 2006, if the closing sale price per share of our common stock exceeds 120% of the conversion price 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 convertible notes also contain put options, which may require us, at the option of the holder, to repurchase all or a portion of the convertible notes on August 1, 2011, August 1, 2016 and August 1, 2021 at the principal amount, plus accrued and unpaid interest.

21

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.

Net proceeds of approximately \$336.3 million may be used to acquire or invest in businesses, products or technologies that are complementary to our own. We may also use the proceeds for general corporate purposes. The convertible notes are unsecured and subordinate to all of our existing and future senior indebtedness. The convertible notes are currently not guaranteed by any of our operating subsidiaries. However, the convertible notes will be unconditionally guaranteed, joint and severally, by any future subsidiaries that guarantee our senior subordinated notes. 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 December 31, 2006. The aggregate principal amount of the convertible notes is included in long-term debt as they can not be converted prior to July 2011, unless certain defined events occur. At such time the holders have the ability to convert, we will reclassify the convertible notes from long-term to current to reflect the holders' conversion rights.

Senior Secured Credit Facility

At December 31, 2005, we had \$24.7 million remaining on our original \$185 million seven-year senior secured term loan (term loan), which we repaid during the first quarter of 2006. The term loan was part of our senior secured credit facility (credit facility), which originated on July 1, 2004 to finance the acquisition of our Electricity Metering business. The credit facility also includes a \$55 million five-year senior secured revolving credit line (revolver). We have the ability to increase the revolver to \$75 million at a future date. Our letter of credit limit under the credit facility is \$55 million and can be increased to \$65 million at a future date. The credit facility is guaranteed by all of our operating subsidiaries, except for our foreign subsidiaries, all of which are wholly owned.

At December 31, 2006, there were no borrowings outstanding under the revolver and \$23.0 million was utilized by outstanding standby letters of credit resulting in \$32.0 million available for additional borrowings. Revolver borrowings can be made at any time through June 2009, at which time any borrowings outstanding must be repaid. Our debt covenants require us to maintain certain consolidated leverage and coverage ratios on a quarterly basis, as well as customary covenants that place restrictions on the incurrence of debt, the payment of dividends, certain investments and mergers. We were in compliance with these debt covenants at December 31, 2006 and 2005.

Interest rates on the revolver vary depending on our consolidated leverage ratio and are based on the London InterBank Offering Rate (LIBOR) plus 1.0% to 2.0%, or Prime plus zero to 1.5%, payable at various intervals depending on the term of the borrowing. The annual commitment fee on the unused portion of the revolver varies from 0.25% to 0.50%. We incur annual letter of credit fees based on (a) a fronting fee of 0.125% and (b) a letter of credit fee that varies from 1.0% to 2.0%.

Real Estate Term Note

On December 30, 2005, we signed a real estate term note (real estate note) for \$14.8 million, secured by real property, with principal payments of \$740,000, plus interest, payable quarterly, commencing April 1, 2006 and continuing through January 1, 2011. During the first quarter of 2006, we made an optional prepayment of \$10.0 million on the real estate note. During April 2006, we completed the repayment of the real estate note.

Project Financing

In May 1998, in conjunction with project financing for one of our outsourcing contracts, we issued a note secured by the assets of the project with monthly interest payments at an annual interest rate of 7.6%, maturing May 31, 2009. During April 2006, we repaid the balance of the project financing loan, which included \$107,000 in prepayment fees.

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 \$13.2 million and \$8.9 million at December 31, 2006 and 2005, respectively. For the year ended December 31, 2006, total interest cost was \$18.7 million, of which \$900,000 was capitalized as part of our new corporate headquarters capital improvements. There was no capitalized interest in 2005 or 2004. Accrued interest expense was \$4.8 million and \$1.3 million at December 31, 2006 and 2005, respectively.

Minimum Payments on Debt

Our outstanding debt has no required minimum payments due over the next five years. Our subordinated notes are due on May 15, 2012. Our convertible notes can be converted at any time as a result of certain corporate transactions or defined market conditions, as outlined above, or no earlier than July 1, 2011.

Note 10: Fair Values of Financial Instruments

The estimated fair value of financial instruments has been determined by using available market information and appropriate valuation methodologies. The values provided are representative of fair values only as of December 31, 2006 and 2005, and do not reflect subsequent changes in the economy, interest and tax rates and other variables that may affect determination of fair value. The following methods and assumptions were used in estimating fair values.

Cash and cash equivalents: Due to the liquid nature of these instruments, the carrying value approximates fair value.

Short-term investments, held to maturity: The fair value is based on quoted market prices, which approximates the carrying amount because of the short maturity of these instruments.

Senior subordinated notes: The 2006 fair value is based on the latest quoted market price at December 31, 2006. The fair value at December 31, 2005 is based on an internally generated fair value model, using estimated spreads above quoted treasury rates for similar issues as this borrowing had very little trading activity during 2005.

Convertible senior subordinated notes: The fair value is based on the latest quoted market price at December 31, 2006.

Senior secured credit facility term loan: The carrying value approximates fair value as the interest rates are periodically adjusted to market rates by our lenders.

Real estate term note: The carrying value approximates fair value as the interest rates are periodically adjusted to market rates by our lender.

Project financing: The fair value is estimated based on an internally generated fair value model, using estimated spreads above quoted treasury rates for similar issues.

	At December 31, 2006		At December 31, 2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)			
Assets				
Cash and cash equivalents	\$ 361,405	\$ 361,405	\$ 33,638	\$ 33,638
Short-term investments, held to maturity	34,583	34,590	-	-
Liabilities				
Senior subordinated notes	124,324	128,438	124,226	124,279
Convertible senior subordinated notes	345,000	366,435	-	-
Senior secured credit facility term loan	-	-	24,676	24,676
Real estate term note	-	-	14,800	14,800
Project financing	-	-	3,227	3,266

Note 11: Restructurings

There was no restructuring activity in 2006 or 2005. During 2004, we implemented a new internal organizational structure, which resulted in several actions to reduce spending and eliminate certain unprofitable activities. As a result, we reduced our staffing by approximately 260 employees and incurred restructuring expenses of \$7.7 million. The liability for employee severance of \$2.3 million was recorded within wages and benefits payable at December 31, 2004. Additional costs of \$390,000 were recorded in 2005, with all severance costs paid to employees by December 31, 2005.

23

Note 12: Income Taxes

A reconciliation of income taxes at the U.S. federal statutory rate of 35% to the consolidated actual tax rate is as follows:

	Year Ended December 31,		
	2006	2005	2004
	(in thousands)		
Income (loss) before income taxes			
Domestic	\$ 52,068	\$ 25,666	\$ (10,220)
Foreign	167	1,862	814
Total income (loss) before income taxes	\$ 52,235	\$ 27,528	\$ (9,406)
Expected federal income tax provision (benefit)	\$ 18,282	\$ 9,635	\$ (3,292)
Tax credits	(2,433)	(2,114)	(971)
State income tax provision (benefit), net of federal effect	2,501	1,488	(477)
Export sales provision (benefit)	(209)	(220)	82
Meals and entertainment	344	309	252
Realization of prior years' deferred tax assets	(615)	(8,534)	-
Change in valuation allowance	(202)	(5,519)	(121)
Foreign operations	(837)	(501)	-
Stock-based compensation	1,876	-	-
Other, net	(231)	(77)	378
Total provision (benefit) for income taxes	\$ 18,476	\$ (5,533)	\$ (4,149)

The provision (benefit) for income taxes consists of the following:

	Year Ended December 31,		
	2006	2005	2004
	(in thousands)		
Current:			
Federal	\$ 2,428	\$ -	\$ -
State and local	1,319	528	449
Foreign	290	356	73
Total current	4,037	884	522
Deferred:			
Federal	15,052	(8,063)	(3,716)
State and local	1,093	1,864	(785)
Foreign	(1,504)	5,301	(49)
Total deferred	14,641	(898)	(4,550)
Change in valuation allowance	(202)	(5,519)	(121)
Total provision (benefit) for income taxes	\$ 18,476	\$ (5,533)	\$ (4,149)

Net deferred income tax assets consist of the following:

At December 31,
2006 **2005**
(in thousands)

Deferred tax assets			
Loss carryforwards	\$	25,266	\$ 31,787
Accrued expenses		14,896	10,539
Tax credits		17,429	19,257
Depreciation and amortization		12,040	10,953
Other, net		857	1,372
Total deferred tax assets		70,488	73,908
Deferred tax liabilities			
Tax effect of accumulated translation		(939)	(444)
Other, net		(191)	(80)
Total deferred tax liabilities		(1,130)	(524)
Valuation allowance		(1,083)	(1,285)
Net deferred tax assets	\$	68,275	\$ 72,099

24

At December 31, 2006, we had unused federal research and development tax credits of \$17.7 million, which expire during the tax years 2007 – 2026 if not utilized. We have state research and development tax credits of approximately \$1.9 million available to offset future state tax liabilities and alternative minimum tax credits of \$2.5 million available to offset future federal tax liabilities, both of which are available indefinitely. Federal loss carryforwards of \$60.4 million expire during the tax years 2019 – 2025. Valuation allowances of \$1.1 million, \$1.3 million and \$6.8 million in 2006, 2005 and 2004, respectively, were provided primarily for foreign loss carryforwards attributable to various items for which we may not receive future benefits. The tax benefit associated with equity compensation was \$13.5 million, \$15.1 million and \$2.6 million in 2006, 2005 and 2004, respectively, and is included in the Consolidated Statements of Shareholders' Equity.

Note 13: Shareholder Rights Plan

On November 4, 2002, the Board of Directors authorized the implementation of a Shareholder Rights Plan and declared a dividend of one preferred share purchase right (a Right) for each outstanding share of common stock, without par value. The Rights will separate from the common stock and become exercisable following the earlier of (i) the close of business on the tenth business day after a public announcement that a person or group (including any affiliate or associate of such person or group) has acquired beneficial ownership of 15% or more of the outstanding common shares and (ii) the close of business on such date, if any, as may be designated by the Board of Directors following the commencement of, or first public disclosure of an intent to commence, a tender or exchange offer for outstanding common shares, which could result in the offeror becoming the beneficial owner of 15% or more of the outstanding common shares (the earlier of such dates being the distribution date). After the distribution date, each Right will entitle the holder to purchase, for \$160.00, one one-hundredth (1/100) of a share of Series R Cumulative Participating Preferred Stock of the Company (a Preferred Share) with economic terms similar to that of one common share.

In the event a person or group becomes an acquiring person, the Rights will entitle each holder of a Right to purchase, for the purchase price, that number of common shares equivalent to the number of common shares, which at the time of the transaction would have a market value of twice the purchase price. Any Rights that are at any time beneficially owned by an acquiring person will be null and void and nontransferable and any holder of any such Right will be unable to exercise or transfer any such Right. If, at any time after any person or group becomes an acquiring person, we are acquired in a merger or other business combination with another entity, or if 50% or more of its assets or assets accounting for 50% or more of its net income or revenues are transferred, each Right will entitle its holder to purchase, for the purchase price, that number of shares of common stock of the person or group engaging in the transaction having a then current market value of twice the purchase price. At any time after any person or group becomes an acquiring person, but before a person or group becomes the beneficial owner of more than 50% of the common shares, the Board of Directors may elect to exchange each Right for consideration per Right consisting of one-half of the number of common shares that would be issuable at such time on the exercise of one Right and without payment of the purchase price. At any time prior to any person or group becoming an acquiring person, the Board of Directors may redeem the Rights in whole, but not in part, at a price of \$0.01 per Right, subject to adjustment as provided in the Rights Agreement. The Rights are not exercisable until the distribution date and will expire on December 11, 2012, unless earlier redeemed or exchanged by us.

The terms of the Rights and the Rights Agreement may be amended without the approval of any holder of the Rights, at any time prior to the distribution date. Until a Right is exercised, the holder thereof, as such, will have no rights as a shareholder of the Company, including, without limitation, the right to vote or receive dividends. In order to preserve the actual or potential economic value of the Rights, the number of Preferred Shares or other securities issuable upon exercise of the Right, the purchase price, the redemption price and the number of Rights associated with each outstanding common share are all subject to adjustment by the Board of Directors pursuant to certain customary antidilution provisions. The Rights distribution should not be taxable for federal income tax purposes. Following an event that renders the Rights exercisable or upon redemption of the Rights, shareholders may recognize taxable income.

Note 14: Bonus, Profit Sharing and Employee Savings Plans

We have employee bonus and profit sharing plans in which most of our employees participate, which provide award amounts for the achievement of annual performance and financial targets. Actual award amounts are determined at the end of the year if the performance and financial targets are met. As the bonuses are being earned during the year, we estimate a compensation accrual each quarter based on the progress towards achieving the goals, the estimated financial forecast for the year and the probability of achieving results. An accrual is recorded if management determines it probable that a target will be achieved and the amount can be reasonably estimated. Although we monitor our annual forecast and the progress towards achievement of goals, the actual results at the end of the year may warrant a bonus award that is significantly greater or less than the estimates made in earlier quarters. At December 31, 2006, \$9.4 million of bonus and profit sharing expense was recorded, with payment expected in the first quarter of 2007. For 2005, \$9.7 million of bonus and profit sharing expense was recorded, with payment made in the first quarter of 2006. During 2004, the performance goals were not met; however a discretionary payout of approximately \$500,000 was recorded as expense for fiscal 2004 with payment made during the first quarter of 2005.

Employee Savings Plan

We have an employee incentive savings plan in which substantially all employees are eligible to participate. Employees may contribute, on a tax-deferred basis, from 1% to 50% of their salary, up to the annual Internal Revenue Service limit. We provide a 50% match on the first 6% of the employee salary deferral, subject to statutory limitations. The expense for our matching contribution was \$3.0 million in 2006, \$2.3 million in 2005 and \$2.0 million in 2004.

25

Note 15: Stock-Based Compensation*Stock Option Plans*

At December 31, 2006, we had three stock-based compensation plans in effect, but we are currently only granting options under one, the Amended and Restated 2000 Stock Incentive Plan. Stock options to purchase the Company's common stock are granted 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 a 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. The weighted average fair value of stock options granted in 2006, 2005 and 2004 was \$21.01, \$16.57 and \$12.42, respectively. The compensation expense related to stock options recognized under SFAS 123(R) for the year ended December 31, 2006 was \$8.6 million. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated at the date of grant based on our historical experience and future expectations. Prior to the adoption of SFAS 123(R), the effect of forfeitures on the pro forma expense amounts was recognized as the forfeitures occurred.

A summary of our stock option activity from January 1, 2004 through December 31, 2006 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, 2004	3,887	\$ 13.22		
Granted	875	21.02		
Exercised	(632)	10.37		
Forfeited	(246)	16.43		
Expired	-	-		
Outstanding, December 31, 2004	3,884	\$ 15.24	6.03	\$ 34,003
Exercisable and expected to vest, December 31, 2004	3,688	\$ 14.87	5.92	\$ 33,835
Exercisable, December 31, 2004	2,251	\$ 13.17	5.01	\$ 24,465
Granted	627	36.80		
Exercised	(1,746)	13.64		
Forfeited	(322)	18.64		
Expired	-	-		
Outstanding, December 31, 2005	2,443	\$ 21.24	6.89	\$ 46,189
Exercisable and expected to vest, December 31, 2005	2,313	\$ 20.73	6.81	\$ 44,922
Exercisable, December 31, 2005	1,157	\$ 13.66	5.55	\$ 30,804
Granted	600	49.39		
Exercised	(751)	17.32		
Forfeited	(67)	33.55		
Expired	-	-		
Outstanding, December 31, 2006	2,225	\$ 29.78	7.46	\$ 49,469
	2,004	\$ 28.55	7.31	\$ 46,986

Exercisable and expected to vest,
December 31, 2006

Exercisable, December 31, 2006	1,032	\$	18.13	5.98	\$	34,797
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The aggregate intrinsic value in the table above is before applicable income taxes, based on our closing stock price of \$51.84 as of the last business day of the period ended December 31, 2006, which represents the amounts optionees would have received if all options had been exercised on that date. As of December 31, 2006, total unrecognized stock-based compensation expense related to nonvested stock options was \$16.9 million, which is expected to be recognized over a weighted average period of approximately 21 months. During the years ended December 31, 2006, 2005 and 2004, the total intrinsic value of stock options exercised was \$30.3 million, \$45.4 million and \$6.3 million, respectively. The total fair value of options vested was \$32.5 million, \$14.2 million and \$15.0 million during the years ended December 31, 2006, 2005 and 2004, respectively.

We issue new shares of common stock upon the exercise of stock options.

26

As of December 31, 2006, there were 473,685 shares of common stock available for future grants pursuant to stock-based awards, which includes the stock option plans, the Long-Term Performance Plan and the Directors' stock awards. Additional information regarding options outstanding as of December 31, 2006, is as follows:

Range of Exercise Prices	Shares (in thousands)	Outstanding Options		Exercisable Options	
		Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price per Share	Shares (in thousands)	Weighted Average Exercise Price per Share
\$ 4.87 - \$14.17	339	3.81	\$ 7.66	339	\$ 7.66
\$14.85 - \$20.52	359	6.35	18.60	330	18.55
\$20.64 - \$30.32	470	7.51	21.71	226	21.37
\$37.40 - \$42.62	462	8.27	37.65	136	37.67
\$48.51 - \$55.80	562	9.56	48.59	1	50.29
\$56.60 - \$70.99	33	9.34	62.80	-	-
	2,225	7.46	\$ 29.78	1,032	\$ 18.13

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 employee stock purchase plan (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 48,442 and 62,498 shares to employees in the years ended December 31, 2006 and 2005, 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 2006, 2005 and 2004 was \$8.63, \$6.85 and \$4.45, respectively. The expense related to ESPP recognized under SFAS 123(R) for the year ended December 31, 2006 was \$386,000. We had no unrecognized compensation cost at December 31, 2006 associated with the awards issued under the ESPP. As of December 31, 2006, there were 381,846 shares of common stock available for future issuance under the Employee Stock Purchase Plan.

Long-Term Performance Plan

We have a Long-Term Performance Plan (LTPP) for senior management with restricted stock awards contingent on the attainment of yearly goals payable in the Company's common stock with a three-year cliff vesting period. Restricted stock awards are granted in the year following attainment, as approved by our Board of Directors. The value of an award is based on a percentage of the participant's base salary and is dependent on performance objectives for the period. We currently have two active plans, one for 2005 and another for 2006.

The award for 2005 consisted of 30,542 shares of restricted stock issued on February 15, 2006, at a grant-date fair value of \$59.16. For the years ended December 31, 2006 and 2005, approximately \$226,000 and \$485,000 were recognized as expense for the 2005 award, respectively. As of December 31, 2006, total unrecognized stock-based compensation expense related to the 2005 award was \$684,000, which will be recognized through February 15, 2009. For the 2006 yearly goals the number of shares of restricted stock to be issued will be determined by dividing the dollar amount of the award by the fair value of our common stock on the date the award is approved by our Board of

Directors. For the year ended December 31, 2006, \$209,000 was recognized as expense related to the 2006 award, with the remaining \$1.3 million to be recognized through February, 2010.

A summary of the restricted stock activity for the year ended December 31, 2006 is as follows:

	Restricted Shares
Nonvested, January 1, 2006	-
Granted	30,542
Vested	(1,171)
Forfeited	(6,938)
Nonvested, December 31, 2006	22,433

27

Board of Directors' Unrestricted Stock Awards

We issue unrestricted stock awards to our Board of Directors as part of the Board of Directors' compensation. During the year ended December 31, 2006, we issued 5,762 shares of unrestricted stock to our Board of Directors, with a weighted average grant-date fair value of \$50.71. The expense related to these awards for the year ended December 31, 2006 was \$292,000. All awards were fully vested and expensed when granted.

Note 16: Commitments and Contingencies*Commitments*

We have noncancelable operating leases for computers, office, production and storage space expiring at various dates through 2011. Rent expense under our operating leases was \$7.0 million in 2006, \$7.6 million in 2005 and \$8.1 million in 2004. We receive lease income on a portion of our Spokane Valley facility from another entity. Future minimum payments and revenues at December 31, 2006, under noncancelable operating leases with initial or remaining terms in excess of one year are as follows:

	Minimum Payments	Minimum Revenues
	(in thousands)	
2007	\$ 5,263	\$ 176
2008	4,121	279
2009	2,769	386
2010	1,731	386
2011	1,382	386
	\$ 15,266	\$ 1,613

Rent expense and income, net of any leasehold incentive, is recognized straightline over the lease term, including renewal periods if reasonably assured. Our most significant operating leases include our manufacturing facility in Waseca, Minnesota and office space for our software operations in Raleigh, North Carolina and Oakland and San Diego, California. Our leases typically contain renewal options similar to the original terms with lease payments that increase based on the consumer price index.

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. No liabilities were required for agreements entered into during the years ended December 31, 2006 and 2005.

We maintain bid and performance bonds for certain customers. Bonds in force were \$6.0 million and \$3.0 million at December 31, 2006 and 2005, respectively. Bid bonds guarantee that we will enter into a contract consistent with the terms of the bid. Performance bonds 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.

We also have standby letters of credit to guarantee our performance under certain contracts. The outstanding amounts of standby letters of credit were \$23.0 million and \$22.6 million at December 31, 2006 and 2005, respectively.

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.

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 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. At December 31, 2006, there were no material legal contingencies requiring accrual or disclosure.

28

Note 17: Segment Information

Subsequent to the filing of our Annual Report on Form 10-K for the year ended December 31, 2006, which was originally filed with the SEC on February 23, 2007, and in connection with the close of the Actaris Metering Systems SA (Actaris) acquisition on April 18, 2007, we realigned our previously reported operating segments into two groups, Itron North America and Actaris, to reflect the way we are managing our business after the Actaris acquisition. Our Itron North America operating segment represents our operations prior to the Actaris acquisition, which are primarily located in North America. Prior to the Actaris acquisition, Itron North America previously consisted of three operating segments, as previously reported: Electricity Metering, Meter Data Collection and Software Solutions. Our Actaris operating segment represents the operations of the Actaris acquisition, which are primarily located outside of North America. As such operating segment was not acquired prior to December 31, 2006, such segment is not included in the operating segment information below. The operating segment information as set forth below, for the years ended December 31, 2006, 2005 and 2004 is based on the new segment reporting structure as of June 30, 2007. Historical segment information has been restated from the segment information previously provided to conform to the segment reporting structure after the April 2007 Actaris acquisition in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*.

Corporate operating expenses, interest income, interest expense, other income (expense) and income tax expense (benefit) are not allocated to the Itron North America segment, 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. Approximately 99% of depreciation expense was allocated to the Itron North America segment at December 31, 2006, 2005 and 2004, with the remaining portion reported under corporate unallocated.

We classify our Itron North America products as either hardware or software. Hardware revenues were 91% in 2006 and 2005 and 88% in 2004. Software revenues were 9% in 2006 and 2005 and 12% in 2004. We classify sales in the United States and Canada as domestic revenues. International revenues were \$41.1 million, \$39.3 million and \$25.9 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Segment Products**Segment***Itron North America***Major Products**

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, maintenance support and other services.

Segment Information

	Year Ended December 31,		
	2006	2005	2004
	(in thousands)		
Revenues - Itron North America	\$ 644,042	\$ 552,690	\$ 399,194
Gross margin - Itron North America	267,442	233,621	170,669
Operating income (loss)			
Itron North America	89,028	69,953	27,029
Corporate unallocated	(27,285)	(23,715)	(23,067)
Total Company	61,743	46,238	3,962
Total other income (expense)	(9,508)	(18,710)	(13,368)
Income (loss) before income taxes	\$ 52,235	\$ 27,528	\$ (9,406)

One customer accounted for 16% of total Company revenues in 2006. No single customer represented more than 10% of total Company revenues in 2005 and 2004.

Note 18: Condensed Consolidating Financial Information

Subsequent to the filing of our Annual Report on Form 10-K for the year ended December 31, 2006, which was originally filed with the SEC on February 23, 2007, we determined that the required disclosure under SEC Regulation S-X Rule 3-10, *Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered*, had been omitted. As a result, the previously omitted information is being presented below.

Our senior 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. Our convertible senior subordinated notes (convertible notes) were not guaranteed by any of our subsidiaries on the date of issuance. However, our guarantees under the convertible notes will be joint and several, full, complete and unconditional by any future subsidiaries that guarantee our senior subordinated notes.

There are currently no restrictions on the ability of the subsidiary guarantors to transfer funds to the parent company.

29

Effective January 1, 2006, the legal entity holding the U.S. operations of our Electricity Metering business (a guarantor subsidiary) was merged into the parent company. As a result of this merger, the assets, liabilities and operations of this guarantor subsidiary have been combined with the parent company as of and for the year ended December 31, 2006. In addition, as a result of our legal entity merger on January 1, 2006, we have restated the parent and guarantor subsidiary information for the 2005 and 2004 periods presented to reflect the new legal entity structure.

During the second quarter of 2006, we acquired Quantum and ELO (see Note 5). Commencing on the date of acquisition, Quantum's financial results are reflected within the parent company. The financial results of the wholly-owned entities that hold the investment in ELO are reflected within the guarantor subsidiaries, whereas the financial results of ELO are reflected within the non-guarantor subsidiaries.

Consolidating Statement of Operations
Year Ended December 31, 2006

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
Revenues					
Sales	\$ 561,583	\$ -	\$ 52,428	\$ (20,021)	\$ 593,990
Service	56,943	-	9,540	(16,431)	50,052
Total revenues	618,526	-	61,968	(36,452)	644,042
Cost of revenues					
Sales	338,993	-	30,252	(20,035)	349,210
Service	25,235	-	17,908	(15,753)	27,390
Total cost of revenues	364,228	-	48,160	(35,788)	376,600
Gross profit	254,298	-	13,808	(664)	267,442
Operating expenses					
Sales and marketing	56,937	-	6,650	-	63,587
Product development	58,208	-	1,389	(823)	58,774
General and administrative	48,997	-	3,058	158	52,213
Amortization of intangible assets	29,801	-	1,324	-	31,125
Total operating expenses	193,943	-	12,421	(665)	205,699
Operating income	60,355	-	1,387	1	61,743
Other income (expense)					
Interest income	9,705	-	175	(383)	9,497
Interest expense	(17,444)	-	(723)	382	(17,785)
Other income (expense), net	(818)	-	(402)	-	(1,220)
Total other income (expense)	(8,557)	-	(950)	(1)	(9,508)
Income before income taxes	51,798	-	437	-	52,235
Income tax (provision) benefit	(19,532)	-	1,056	-	(18,476)
Equity in earnings (losses) of guarantor and					

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non-guarantor subsidiaries	1,493	(1,451)	-	(42)	-
Net income (loss)	\$ 33,759	\$ (1,451)	\$ 1,493	\$ (42)	\$ 33,759

30

Consolidating Statement of Operations
Year Ended December 31, 2005

	Parent	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
	(in thousands)			
Revenues				
Sales	\$ 488,755	\$ 40,365	\$ (25,850)	\$ 503,270
Service	45,078	8,250	(3,908)	49,420
Total revenues	533,833	48,615	(29,758)	552,690
Cost of revenues				
Sales	285,771	31,647	(25,973)	291,445
Service	24,955	6,362	(3,693)	27,624
Total cost of revenues	310,726	38,009	(29,666)	319,069
Gross profit	223,107	10,606	(92)	233,621
Operating expenses				
Sales and marketing	51,552	5,087	3	56,642
Product development	46,922	424	(269)	47,077
General and administrative	42,524	1,736	168	44,428
Amortization of intangible assets	38,846	-	-	38,846
Restructurings	197	193	-	390
Total operating expenses	180,041	7,440	(98)	187,383
Operating income	43,066	3,166	6	46,238
Other income (expense)				
Interest income	408	29	(135)	302
Interest expense	(18,655)	(430)	141	(18,944)
Other income (expense), net	2	(58)	(12)	(68)
Total other income (expense)	(18,245)	(459)	(6)	(18,710)
Income before income taxes	24,821	2,707	-	27,528
Income tax benefit (provision)	5,882	(349)	-	5,533
Equity in earnings of non-guarantor subsidiaries	2,358	-	(2,358)	-
Net income	\$ 33,061	\$ 2,358	\$ (2,358)	\$ 33,061

Consolidating Statement of Operations
Year Ended December 31, 2004

	Parent	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
	(in thousands)			
Revenues				
Sales	\$ 338,729	\$ 18,756	\$ (10,942)	\$ 346,543
Service	45,983	8,392	(1,724)	52,651
Total revenues	384,712	27,148	(12,666)	399,194
Cost of revenues				
Sales	193,005	16,188	(11,062)	198,131
Service	27,538	3,441	(585)	30,394
Total cost of revenues	220,543	19,629	(11,647)	228,525
Gross profit	164,169	7,519	(1,019)	170,669
Operating expenses				
Sales and marketing	41,899	3,003	377	45,279
Product development	44,961	910	(1,492)	44,379
General and administrative	34,086	1,308	96	35,490
Amortization of intangible assets	27,901	-	-	27,901
Restructurings	6,878	380	-	7,258
In-process research and development	6,400	-	-	6,400
Total operating expenses	162,125	5,601	(1,019)	166,707
Operating income	2,044	1,918	-	3,962
Other income (expense)				
Interest income	585	10	(429)	166
Interest expense	(12,793)	(781)	429	(13,145)
Other income (expense), net	(732)	343	-	(389)
Total other income (expense)	(12,940)	(428)	-	(13,368)
Income (loss) before income taxes	(10,896)	1,490	-	(9,406)
Income tax benefit (provision)	4,684	(535)	-	4,149
Equity in earnings of non-guarantor subsidiaries	955	-	(955)	-
Net income (loss)	\$ (5,257)	\$ 955	\$ (955)	\$ (5,257)

32

Consolidating Balance Sheet
December 31, 2006

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
ASSETS					
Current assets					
Cash and cash equivalents	\$ 353,483	\$ -	\$ 7,922	\$ -	\$ 361,405
Short-term investments, held to maturity	34,583	-	-	-	34,583
Accounts receivable, net	95,041	-	14,883	-	109,924
Intercompany accounts receivable	6,486	-	3,263	(9,749)	-
Inventories	49,233	-	3,263	-	52,496
Deferred income taxes, net	19,758	-	1,158	-	20,916
Other	15,394	-	1,727	-	17,121
Intercompany other	1,698	-	5,000	(6,698)	-
Total current assets	575,676	-	37,216	(16,447)	596,445
Property, plant and equipment, net					
Property, plant and equipment, net	86,594	-	2,095	-	88,689
Intangible assets, net	104,731	-	7,951	-	112,682
Goodwill	113,481	-	12,785	-	126,266
Deferred income taxes, net	44,702	-	2,698	-	47,400
Intercompany notes receivable	12,257	-	1,242	(13,499)	-
Other	47,041	531	1,390	(31,922)	17,040
Total assets	\$ 984,482	\$ 531	\$ 65,377	\$ (61,868)	\$ 988,522
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities					
Accounts payable and accrued expenses	\$ 41,047	\$ -	\$ 2,875	\$ -	\$ 43,922
Intercompany accounts payable	3,263	-	6,486	(9,749)	-
Wages and benefits payable	22,673	-	1,541	-	24,214
Current portion of warranty	7,850	-	149	-	7,999
Short-term intercompany advances	5,001	-	1,697	(6,698)	-
Unearned revenue	26,004	-	1,445	-	27,449
Total current liabilities	105,838	-	14,193	(16,447)	103,584
Long-term debt					
Long-term debt	469,324	-	-	-	469,324
Warranty	10,149	-	-	-	10,149
Intercompany notes payable	1,241	-	12,258	(13,499)	-
Contingent purchase price	5,879	-	-	-	5,879
Other obligations	1,069	-	7,535	-	8,604
Total liabilities	593,500	-	33,986	(29,946)	597,540

Shareholders' equity					
Preferred stock	-	-	-	-	-
Common stock	351,018	1,982	30,113	(32,095)	351,018
Accumulated other comprehensive income (loss), net	1,588	-	5,767	(5,767)	1,588
Retained earnings (accumulated deficit)	38,376	(1,451)	(4,489)	5,940	38,376
Total shareholders' equity	390,982	531	31,391	(31,922)	390,982
Total liabilities and shareholders' equity	\$ 984,482	\$ 531	\$ 65,377	\$ (61,868)	\$ 988,522

Consolidating Balance Sheet
At December 31, 2005

	Parent	Combined Non-guarantor Subsidiaries	Eliminations	Consolidated
	(in thousands)			
ASSETS				
Current assets				
Cash and cash equivalents	\$ 28,064	\$ 5,574	\$ -	\$ 33,638
Accounts receivable, net	96,707	7,721	-	104,428
Intercompany accounts receivable	3,460	8,977	(12,437)	-
Inventories	46,792	2,664	-	49,456
Deferred income taxes, net	22,895	299	-	23,194
Other	8,575	2,366	-	10,941
Intercompany other	227	3,500	(3,727)	-
Total current assets	206,720	31,101	(16,164)	221,657
Property, plant and equipment, net				
Intangible assets, net	74,097	3,526	-	77,623
Goodwill	123,233	60	-	123,293
Deferred income taxes, net	103,305	12,727	-	116,032
Intercompany notes receivable	47,987	1,806	(838)	48,955
Other	1,966	-	(1,966)	-
Total assets	\$ 600,497	\$ 49,268	\$ (50,881)	\$ 598,884
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Accounts payable and accrued expenses	\$ 44,720	\$ 1,495	\$ -	\$ 46,215
Intercompany accounts payable	8,966	3,471	(12,437)	-
Wages and benefits payable	22,761	971	-	23,732
Current portion of debt	3,516	860	-	4,376
Current portion of warranty	7,972	525	-	8,497
Short-term intercompany advances	-	3,727	(3,727)	-
Unearned revenue	21,801	957	-	22,758
Total current liabilities	109,736	12,006	(16,164)	105,578
Long-term debt				
Project financing debt	160,186	-	-	160,186
Intercompany notes payable	-	2,367	-	2,367
Warranty	-	1,966	(1,966)	-
Deferred income taxes, net	6,708	71	-	6,779
Other obligations	-	838	(838)	-
Total liabilities	282,963	17,355	(18,968)	281,350
Shareholders' equity				
Preferred stock	-	-	-	-
Common stock	312,046	28,132	(28,132)	312,046

Accumulated other comprehensive income (loss), net	871	4,962	(4,962)	871
Retained earnings (accumulated deficit)	4,617	(1,181)	1,181	4,617
Total shareholders' equity	317,534	31,913	(31,913)	317,534
Total liabilities and shareholders' equity	\$ 600,497	\$ 49,268	\$ (50,881)	\$ 598,884

34

Consolidating Statement of Cash Flows
Year Ended December 31, 2006

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries (in thousands)	Eliminations	Consolidated
Operating activities					
Net income (loss)	\$ 33,759	\$ (1,451)	\$ 1,493	\$ (42)	\$ 33,759
Adjustments to reconcile net income (loss) to net cash provided by operating activities:					
Depreciation and amortization	44,153	-	2,081	-	46,234
Employee stock plans income tax benefits	13,547	-	-	-	13,547
Excess tax benefits from stock-based compensation	(9,717)	-	-	-	(9,717)
Stock-based compensation	9,689	-	-	-	9,689
Amortization of prepaid debt fees	4,526	-	-	-	4,526
Deferred income taxes, net	3,764	-	(2,140)	-	1,624
Equity in (earnings) losses of non-guarantor subsidiaries	(1,493)	1,451	-	42	-
Other, net	846	-	(18)	-	828
Changes in operating assets and liabilities, net of acquisitions:					
Accounts receivable	3,863	-	(7,138)	-	(3,275)
Inventories	(1,948)	-	349	-	(1,599)
Long-term note receivable, net	-	-	-	-	-
Accounts payable and accrued expenses	(5,212)	-	(3,066)	-	(8,278)
Wages and benefits payable	(1,966)	-	192	-	(1,774)
Unearned revenue	5,033	-	665	-	5,698
Warranty	3,319	-	(447)	-	2,872
Other long-term obligations	(497)	-	11	-	(486)
Intercompany transactions, net	(8,404)	-	8,404	-	-
Other, net	560	-	565	-	1,125
Net cash provided by operating activities	93,822	-	951	-	94,773
Investing activities					
Purchases of investments, held to maturity	(204,995)	-	-	-	(204,995)
Proceeds from the maturities of investments, held to maturity	170,381	-	53	-	170,434
Acquisitions of property, plant and equipment	(30,702)	-	(1,037)	-	(31,739)

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Business acquisitions, net of cash and cash equivalents acquired	(19,889)	-	(1,232)	-	(21,121)
Cash transferred to parent	-	-	(3,303)	3,303	-
Cash transferred to non-guarantor subsidiaries	(760)	-	-	760	-
Intercompany notes, net	-	-	8,133	(8,133)	-
Other, net	672	-	1,250	-	1,922
Net cash (used in) provided by investing activities	(85,293)	-	3,864	(4,070)	(85,499)
Financing activities					
Proceeds from borrowings	345,000	-	-	-	345,000
Payments on debt	(39,476)	-	(3,227)	-	(42,703)
Issuance of common stock	15,250	-	-	-	15,250
Excess tax benefits from stock-based compensation	9,717	-	-	-	9,717
Prepaid debt fees	(8,771)	-	-	-	(8,771)
Cash transferred from parent	-	-	760	(760)	-
Cash transferred from non-guarantor subsidiaries	3,303	-	-	-	-