ITRON INC /WA/
Form 10-Q
August 06, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from to

Commission file number 000-22418

ITRON, INC.
(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

As of July 31, 2012 there were outstanding 39,517,662 shares of the registrant's common stock, no par value, which is the only class of common stock of the registrant.

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PART I: FINANCIAL INFORMATION
Item 1: Financial Statements (Unaudited)
ITRON, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands, except per share data)			
Revenues	$579,140	$612,401	$1,150,780	$1,176,092
Cost of revenues	382,395	420,450	770,930	799,163
Gross profit	196,745	191,951	379,850	376,929
Operating expenses				
Sales and marketing	50,847	48,671	100,703	93,149
Product development	46,640	40,628	90,996	80,770
General and administrative	33,450	36,463	70,020	71,135
Amortization of intangible assets	12,025	16,197	23,938	31,794
Restructuring expense	7,720	1,907	8,509	1,907
Total operating expenses	150,682	143,866	294,166	278,755
Operating income	46,063	48,085	85,684	98,174
Other income (expense)				
Interest income	177	168	370	476
Interest expense	(2,606)	(11,420)	(5,043)	(23,534)
Other income (expense), net	(779)	(1,350)	(2,955)	(2,940)
Total other income (expense)	(3,208)	(12,602)	(7,628)	(25,998)
Income before income taxes	42,855	35,483	78,056	72,176
Income tax (provision) benefit	(10,564)	80	(20,193)	(9,487)
Net income	32,291	35,563	57,863	62,689
Net income attributable to noncontrolling interests	676	1,127	895	1,133
Net income attributable to Itron, Inc.	$31,615	$34,436	$56,968	$61,556
Earnings per common share - Basic	$0.79	$0.85	$1.43	$1.52
Earnings per common share - Diluted	$0.79	$0.84	$1.42	$1.50
Weighted average common shares outstanding - Basic	39,887	40,670	39,900	40,608
Weighted average common shares outstanding - Diluted	40,126	41,077	40,170	41,059

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

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ITRON, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Net income	$32,291	$35,563	$57,863	$62,689
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(52,331)	23,238	(23,790)	124,057
Unrealized gains (losses) on hedging instruments:				
Net unrealized gain (loss) on derivative instruments, designated as cash flow hedges	(849)	(224)	(849)	(164)
Net unrealized gain (loss) on nonderivative hedging instruments	—	(1,452)	—	(9,262)
Net hedging loss (gain) reclassified into net income	—	1,332	—	2,774
Pension plan benefit liability adjustment	22	24	45	(528)
Total other comprehensive income (loss), net of tax	(53,158)	22,918	(24,594)	116,877
Total comprehensive income (loss), net of tax	(20,867)	58,481	33,269	179,566
Comprehensive income (loss) attributable to noncontrolling interest, net of tax:				
Net income attributable to noncontrolling interest	676	1,127	895	1,133
Foreign currency translation adjustments	40	141	40	513
Amounts attributable to noncontrolling interest	716	1,268	935	1,646
Comprehensive income (loss) attributable to Itron, Inc.	$(21,583)	$57,213	$32,334	$177,920

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

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ITRON, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)

	June 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$102,800	$133,086
Accounts receivable, net	394,065	371,641
Inventories	196,647	195,837
Deferred tax assets current, net	58,175	58,172
Other current assets	92,662	81,618
Total current assets	844,349	840,354
Property, plant, and equipment, net	252,085	262,670
Deferred tax assets noncurrent, net	16,502	22,144
Other long-term assets	29,520	62,704
Intangible assets, net	254,017	239,500
Goodwill	664,440	636,910
Total assets	$2,060,913	$2,064,282
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	$234,714	$246,775
Other current liabilities	68,889	53,734
Wages and benefits payable	86,557	93,730
Taxes payable	11,928	11,526
Current portion of debt	15,000	15,000
Current portion of warranty	42,861	52,588
Unearned revenue	38,202	37,369
Total current liabilities	498,151	510,722
Long-term debt	440,000	437,502
Long-term warranty	23,507	26,948
Pension plan benefit liability	60,822	62,449
Deferred tax liabilities noncurrent, net	23,941	31,699
Other long-term obligations	74,811	73,417
Total liabilities	1,121,232	1,142,737
Commitments and contingencies		
Equity		
Preferred stock	—	—
Common stock	1,304,089	1,319,222
Accumulated other comprehensive loss, net	(61,794)	(37,160)
Accumulated deficit	(318,169)	(375,137)
Total Itron, Inc. shareholders' equity	924,126	906,925

Noncontrolling interests	15,555	14,620
Total equity	939,681	921,545
Total liabilities and equity	$2,060,913	$2,064,282

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

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

	Six Months Ended June 30, 2012	2011
	(in thousands)	
Operating activities		
Net income	$57,863	$62,689
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	54,271	64,299
Stock-based compensation	9,256	9,518
Amortization of prepaid debt fees	763	2,265
Amortization of convertible debt discount	—	5,336
Deferred taxes, net	628	6,081
Restructuring expense, non-cash	1,487	—
Other adjustments, net	(11)	(848)
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable	8,046	(12,106)
Inventories	(2,786)	(36,668)
Other current assets	(13,663)	(21,268)
Other long-term assets	3,559	(22,993)
Accounts payables, other current liabilities, and taxes payable	(5,817)	16,523
Wages and benefits payable	(11,244)	(21,531)
Unearned revenue	5,627	24,159
Warranty	(11,991)	9,510
Other operating, net	(3,598)	2,726
Net cash provided by operating activities	92,390	87,692
Investing activities		
Acquisitions of property, plant, and equipment	(23,547)	(28,712)
Business acquisitions, net of cash and cash equivalents acquired	(79,605)	(14,635)
Other investing, net	3,993	513
Net cash used in investing activities	(99,159)	(42,834)
Financing activities		
Proceeds from borrowings	70,000	—
Payments on debt	(67,502)	(55,630)
Issuance of common stock	2,407	2,553
Repurchase of common stock	(25,976)	—
Other financing, net	(271)	(319)
Net cash used in financing activities	(21,342)	(53,396)
Effect of foreign exchange rate changes on cash and cash equivalents	(2,175)	7,345
Decrease in cash and cash equivalents	(30,286)	(1,193)
Cash and cash equivalents at beginning of period	133,086	169,477
Cash and cash equivalents at end of period	$102,800	$168,284

Non-cash transactions:		
Property, plant, and equipment purchased but not yet paid, net	$(2,375)	$978
Fair value of contingent and deferred consideration payable for business acquisition	—	5,108
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes, net	$20,173	$6,842
Interest, net of amounts capitalized	4,275	15,927

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

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ITRON, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2012
(UNAUDITED)

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

Note 1: Summary of Significant Accounting Policies

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

Financial Statement Preparation

The condensed consolidated financial statements presented in this Quarterly Report on Form 10-Q are unaudited and reflect entries necessary for the fair presentation of the Consolidated Statements of Operations and the Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2012 and 2011, the Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011 of Itron, Inc. and its subsidiaries. All entries required for the fair presentation of the financial statements are of a normal recurring nature, except as disclosed.

Certain information and notes normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim results. These condensed consolidated financial statements should be read in conjunction with the 2011 audited financial statements and notes included in our Current Report on Form 8-K filed with the SEC on May 24, 2012. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

Basis of Consolidation

We consolidate all entities in which we have a greater than 50% ownership interest or in which we exercise control over the operations. We use the equity method of accounting for entities in which we have a 50% or less investment and exercise significant influence. Entities in which we have less than a 20% investment and where we do not exercise significant influence are accounted for under the cost method. Intercompany transactions and balances have been eliminated upon consolidation.

Noncontrolling Interests

In several of our consolidated international subsidiaries, we have joint venture partners, who are minority shareholders. Although these entities are not wholly-owned by Itron, we consolidate them because we have a greater than 50% ownership interest or because we exercise control over the operations. The noncontrolling interest balance is adjusted each period to reflect the allocation of net income (loss) and other comprehensive income (loss) attributable to the noncontrolling interests, as shown in our Consolidated Statements of Operations and our Consolidated Statements of Comprehensive Income (Loss). The noncontrolling interest balance in our Consolidated Balance Sheets represents the proportional share of the equity of the joint venture entities, which is attributable to the minority shareholders.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current classifications in the Consolidated Statements of Operations. These reclassifications relate to certain administrative expenses in North America that were previously allocated to cost of revenues and sales and marketing and product development operating expenses in prior periods but have been reclassified to general and administrative operating expenses to conform to our worldwide presentation. These reclassifications did not have a material impact to gross profit and had no impact on income before income taxes, net income attributable to Itron, Inc., earnings per share, or total equity.

Business Acquisitions

On May 1, 2012, we completed the acquisition of SmartSynch, Inc. (SmartSynch). The acquisition was financed through borrowings on our multicurrency revolving line of credit and cash on hand. SmartSynch is a provider of smart grid solutions that utilize cellular networks for communications. We have included supplemental pro forma financial information related to the acquisition in Note 16 Business Combinations.

In January 2011, we completed the acquisition of Asais S.A.S. and Asais Conseil S.A.S. (collectively Asais), an energy information management software and consulting services provider, located in France. The acquisition consisted of cash and contingent consideration. Additional acquisitions were completed in 2011, which were immaterial to our financial position, results of operations, and cash flows. (See Business Combinations policy below.)

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. The cash and cash equivalents balance in our Consolidated Balance Sheets includes amounts that reside in our joint venture entities. As a result, the minority shareholders of these entities control their proportional share of the cash and cash equivalents balance, and there may be limitations on Itron to repatriate cash to the U.S. from these entities.

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. We record an allowance for doubtful accounts representing our estimate of the probable losses in accounts receivable at the date of the balance sheet based on our historical experience of bad debts and our specific review of outstanding receivables. 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.

Derivative Instruments
All derivative instruments, whether designated in hedging relationships or not, are recorded on the Consolidated Balance Sheets at fair value as either assets or liabilities. The components and fair values of our derivative instruments are determined using the fair value measurements of significant other observable inputs (Level 2), as defined by GAAP. The net fair value of our derivative instruments may switch between a net asset and a net liability depending on market circumstances at the end of the period. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments are in a net asset position and the effect of our own nonperformance risk when the net fair value of our derivative instruments are in a net liability position.

For any derivative designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. For any derivative designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded as a component of other comprehensive income (loss) (OCI) and are recognized in earnings when the hedged item affects earnings. For a hedge of a net investment, the effective portion of any unrealized gain or loss from the foreign currency revaluation of the hedging instrument is reported in OCI as a net unrealized gain or loss on derivative instruments. Upon termination of a net investment hedge, the net derivative gain/loss will remain in accumulated OCI until such time when earnings are impacted by a sale or liquidation of the associated operations. Ineffective portions of fair value changes or the changes in fair value of derivative instruments that do not qualify for hedging activities are recognized in other income (expense) in the Consolidated Statements of Operations. We classify cash flows from our derivative programs as cash flows from operating activities in the Consolidated Statements of Cash Flows.

Derivatives are not used for trading or speculative purposes. Our derivatives are with credit worthy multinational commercial banks, with whom we have master netting agreements; however, our derivative positions are not disclosed on a net basis. There are no credit-risk-related contingent features within our derivative instruments. Refer to Note 7 and Note 13 for further disclosures of our derivative instruments and their impact on OCI.

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 30 years for buildings and improvements and three to ten years for machinery and equipment, computers and purchased software, and furniture. Leasehold improvements are capitalized and amortized over the term of the applicable lease, including renewable periods if reasonably assured, or over the useful lives, whichever is shorter. Construction in process represents capital expenditures incurred for assets not yet placed in service. Costs related to internally developed software and software purchased for internal uses are capitalized and are amortized over the estimated useful lives of the assets. Repair and maintenance costs are expensed as incurred. We have no major planned maintenance activities.

We review long-lived assets for impairment whenever events or circumstances indicate the carrying amount of an asset or asset group may not be recoverable. Assets held for sale are classified within other current assets in the Consolidated Balance Sheets, are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Gains and losses from asset disposals and impairment losses are classified within the Consolidated Statement of Operations according to the use

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of the asset, except those gains and losses recognized in conjunction with our restructuring activities, which are classified as restructuring expense.

Prepaid Debt Fees

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

Business Combinations

On the date of acquisition, the assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree are recorded at their fair values. The acquiree's results of operations are also included as of the date of acquisition in our consolidated results. Intangible assets that arise from contractual/legal rights, or are capable of being separated, as well as in-process research and development (IPR&D), are measured and recorded at fair value, and amortized over the estimated useful life. IPR&D is not amortized until such time as the associated development projects are completed or terminated. If a development project is completed, the IPR&D is reclassified as a core technology intangible asset and amortized over its estimated useful life. If the development project is terminated, the recorded value of the associated IPR&D is immediately expensed. If practicable, assets acquired and liabilities assumed arising from contingencies are measured and recorded at fair value. If not practicable, such assets and liabilities are measured and recorded when it is probable that a gain or loss has occurred and the amount can be reasonably estimated. The residual balance of the purchase price, after fair value allocations to all identified assets and liabilities, represents goodwill. Acquisition-related costs are expensed as incurred. Restructuring costs associated with an acquisition are generally expensed in periods subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and acquired income tax uncertainties, including penalties and interest, after the measurement period are recognized as a component of the provision for income taxes. Our acquisitions may include contingent consideration, which require us to recognize the fair value of the estimated liability at the time of the acquisition. Subsequent changes in the estimate of the amount to be paid under the contingent consideration arrangement are recognized in the consolidated statements of operations. Cash payments for contingent or deferred consideration are classified within cash flows from investing activities within the consolidated statements of cash flows.

Goodwill and Intangible Assets

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

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

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

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

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

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

Warranty
We offer standard warranties on our hardware products and large application software products. We accrue the estimated cost of new product warranties based on historical and projected product performance trends and costs during the warranty period. Testing of new products in the development stage helps identify and correct potential warranty issues prior to manufacturing. Continuing quality control efforts during manufacturing reduce our exposure to warranty claims. When our quality control efforts fail to detect a fault in one of our products, we 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 higher than anticipated material, labor, and other costs we may incur to repair or replace projected product failures, and we may incur additional warranty and related expenses in the future with respect to new or established products, which could adversely affect our financial position and results of operations. The long-term warranty balance includes estimated warranty claims beyond one year. Warranty expense is classified within cost of revenues.

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

Asset impairments, net, are determined at the asset group level. An impairment may be recorded for assets that are to be abandoned, are to be sold for less than net book value, or are held for sale in which the estimated proceeds are less than the net book value less costs to sell. We may also recognize impairment on an asset group, which is held and used, when the carrying value is not recoverable and exceeds the asset group's fair value. If an asset group is considered a business, the asset group may consist of property, plant, equipment, intangible assets, and goodwill.

Defined Benefit Pension Plans

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

Share Repurchase Plan

We may repurchase shares of Itron common stock under a twelve-month program, which was authorized by our Board of Directors on October 24, 2011. Share repurchases are made in the open market or in privately negotiated transactions and in accordance with applicable securities laws. Under applicable Washington State law, shares repurchased are retired and not displayed separately as treasury stock on the financial statements. Instead, the value of the repurchased shares is deducted from common stock.

Revenue Recognition

Revenues consist primarily of hardware sales, software license fees, software implementation, project management services,

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installation, consulting, and post-sale maintenance support. Revenues are recognized when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured.

The majority of our revenue arrangements involve multiple deliverables, which combine two or more of the following: hardware, meter reading system software, installation, and/or project management services. Revenue arrangements with multiple deliverables are divided into separate units of accounting if the delivered item(s) has value to the customer on a standalone basis and delivery/performance of the undelivered item(s) is probable. The total arrangement consideration is allocated among the separate units of accounting based on their relative fair values and the applicable revenue recognition criteria considered for each unit of accounting. The amount allocable to a delivered item is limited to the amount that we are entitled to collect and that is not contingent upon the delivery/performance of additional items. Revenues for each deliverable are then recognized based on the type of deliverable, such as 1) when the products are shipped, 2) services are delivered, 3) percentage-of-completion when implementation services are essential to other deliverables in the arrangement, 4) upon receipt of customer acceptance, or 5) transfer of title and risk of loss. The majority of our revenue is recognized when products are shipped to or received by a customer or when services are provided.

We primarily enter into two types of multiple deliverable arrangements, which include a combination of hardware and associated software and services:

- Arrangements that do not include the deployment of our smart metering systems and technology are recognized as follows:

  Hardware revenues are recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions.
  If implementation services are essential to the functionality of the associated software, software and implementation revenues are recognized using either the percentage-of-completion methodology of contract accounting if project costs can be reliably estimated or the completed contract methodology if project costs cannot be reliably estimated.

- Arrangements to deploy our smart metering systems and technology are recognized as follows:

  Hardware revenues are recognized at the time of shipment, receipt by customer, or, if applicable, upon completion of customer acceptance provisions.
  Revenue from associated software and services is recognized using the units-of-delivery method of contract accounting, as the software is essential to the functionality of the related hardware and the implementation services are essential to the functionality of the associated software. This methodology results in the deferral of costs and revenues as professional services and software implementation commence prior to deployment of hardware.

We also enter into multiple deliverable software arrangements that do not include hardware. For this type of arrangement, revenue recognition is dependent upon the availability of vendor specific objective evidence (VSOE) of fair value for each of the deliverables. The lack of VSOE, or the existence of extended payment terms or other inherent risks, may affect the timing of revenue recognition for multiple deliverable software arrangements.

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

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

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

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

Unearned revenue is recorded when a customer pays for products or services, but the criteria for revenue recognition have not been met as of the balance sheet date. Unearned revenues of $67.5 million and $61.0 million at June 30, 2012 and December 31, 2011 related primarily to professional services and software associated with our smart metering contracts, extended or noncustomary warranty, and prepaid post-contract support. Deferred costs are recorded for products or services for which ownership (typically defined as title and risk of loss) has transferred to the customer, but the criteria for revenue recognition have not been met as of the balance sheet date. Deferred costs were $12.7 million and $11.7 million at June 30, 2012 and December 31, 2011 and are recorded within other assets in the Consolidated Balance Sheets.

Hardware and software post-sale maintenance support fees are recognized ratably over the life of the related service contract. Shipping and handling costs and incidental expenses billed to customers are recorded as revenue, with the associated cost charged to cost of revenues. We record sales, use, and value added taxes billed to our customers on a net basis.

Product and Software Development Costs

Product and software development costs primarily include employee compensation and third party contracting fees. We generally do not capitalize product and software development expenses due to the immaterial nature of these costs as a result of the relatively short period of time between technological feasibility and the completion of product and software development.

Stock-Based Compensation

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

Income Taxes

We compute our interim income tax provision through the use of an estimated annual effective tax rate (ETR) applied to year-to-date operating results and specific events that are discretely recognized as they occur. In determining the estimated annual ETR, we analyze various factors, including projections of our annual earnings, taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, our ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments, are reflected in the period in which they occur as an addition to, or reduction from, the income tax provision, rather than included in the estimated annual ETR.

Deferred tax assets and liabilities are recognized based upon anticipated future tax consequences, in each of the jurisdictions in which we operate, attributable to: (1) the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases; and (2) operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The calculation of our tax liabilities involves applying complex tax regulations in different jurisdictions to our tax positions. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amount of deferred tax assets if it is not more likely than not that such assets will be realized. We do not record tax liabilities on undistributed earnings of international subsidiaries that are permanently reinvested.

We utilize a two step approach to account for uncertain tax positions. A tax position is first evaluated for recognition based on its

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

Foreign Exchange

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

Fair Value Measurements

For assets and liabilities measured at fair value, the GAAP fair value hierarchy prioritizes the inputs used in different valuation methodologies, assigning the highest priority to unadjusted quoted prices for identical assets and liabilities in actively traded markets (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs consist of quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in non-active markets; and model-derived valuations in which significant inputs are corroborated by observable market data either directly or indirectly through correlation or other means. Inputs may include yield curves, volatility, credit risks, and default rates.

Use of Estimates

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

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Note 2: Earnings Per Share and Capital Structure

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands, except per share data)			
Net income available to common shareholders	$31,615	$34,436	$56,968	$61,556
Weighted average common shares outstanding - Basic	39,887	40,670	39,900	40,608
Dilutive effect of convertible notes	—	—	—	—
Dilutive effect of stock-based awards	239	407	270	451
Weighted average common shares outstanding - Diluted	40,126	41,077	40,170	41,059
Earnings per common share - Basic	$0.79	$0.85	$1.43	$1.52
Earnings per common share - Diluted	$0.79	$0.84	$1.42	$1.50

Convertible Notes

Our convertible notes, which were repaid/redeemed during the third quarter of 2011, contained a provision that would have required us to settle the principal amount of the convertible notes in cash and settle the remaining conversion obligation (stock price in excess of conversion price) in cash, shares, or a combination thereof. During the periods in which the convertible notes were outstanding, we included in the EPS calculation the amount of shares it would have taken to satisfy the conversion obligation, assuming that all of the convertible notes were converted. The average quarterly closing prices of our common stock were used as the basis for determining the dilutive effect on EPS. The quarterly average closing prices of our common stock for the three and six months ended June 30, 2011 did not exceed the conversion price of $65.16 and, therefore, did not have an effect on diluted shares outstanding.

Stock-based Awards

For stock-based awards, the dilutive effect is calculated using the treasury stock method. Under this method, the dilutive effect is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise, future compensation cost associated with the stock award, and the amount of excess tax benefits, if any. Approximately 1.4 million and 1.3 million stock-based awards were excluded from the calculation of diluted EPS for the three and six months ended June 30, 2012, and approximately 672,000 and 664,000 stock-based awards were excluded from the calculation of diluted EPS for the three and six months ended June 30, 2011, respectively, because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Preferred Stock

We have authorized the issuance of 10 million shares of preferred stock with no par value. In the event of a liquidation, dissolution, or winding up of the affairs of the corporation, whether voluntary or involuntary, the holders of any outstanding preferred stock will be entitled to be paid a preferential amount per share to be determined by the Board of Directors prior to any payment to holders of common stock. Shares of preferred stock may be converted into common stock based on terms, conditions, and rates as defined in the Rights Agreement, which may be adjusted by the Board of Directors. There was no preferred stock sold or outstanding at June 30, 2012 and December 31, 2011.

Stock Repurchase Plan

On October 24, 2011, our Board of Directors authorized a twelve-month repurchase program of up to $100 million of our common stock, which will expire on October 23, 2012. Repurchases are made in the open market or in privately negotiated transactions, and in accordance with applicable securities laws. As of June 30, 2012, we have repurchased $55.4 million of our common stock, with $44.6 million remaining under the repurchase program.

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Note 3: Certain Balance Sheet Components

Accounts receivable, net	June 30, 2012	December 31, 2011
	(in thousands)	
Trade receivables (net of allowance of $5,381and $6,049)	$348,106	$328,845
Unbilled receivables	45,959	42,796
Total accounts receivable, net	$394,065	$371,641

At June 30, 2012 and December 31, 2011, $18.7 million and $2.5 million were recorded within trade receivables as billed but not yet paid by customers in accordance with contract retainage provisions. At June 30, 2012 and December 31, 2011, contract retainage amounts that were unbilled and classified as unbilled receivables were $8.9 million and $7.4 million. These contract retainage amounts within trade receivables and unbilled receivables are expected to be collected within the following 12 months.

At June 30, 2012, long-term unbilled receivables totaled $1.2 million. These long-term unbilled receivables are classified within other long-term assets as collection is not anticipated within the following 12 months. We had no long-term retainage contract receivables at June 30, 2012 as we expect to collect all contract retainage receivables within the following 12 months. At December 31, 2011, long-term unbilled receivables and long-term retainage contracts totaled $31.5 million.

Allowance for doubtful account activity	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Beginning balance	$5,983	$9,030	$6,049	$9,045
Provision (release) of doubtful accounts, net	(230)	298	(290)	(48)
Accounts written-off	(22)	(505)	(261)	(552)
Effects of change in exchange rates	(350)	157	(117)	535
Ending balance	$5,381	$8,980	$5,381	$8,980

Inventories	June 30, 2012	December 31, 2011
	(in thousands)	
Materials	$97,000	$112,470
Work in process	14,232	16,306
Finished goods	85,415	67,061
Total inventories	$196,647	$195,837

Our inventory levels may vary period to period as a result of our factory scheduling and the timing of contract fulfillments, which may include the buildup of finished goods for shipment.

Consigned inventory is held at third-party locations; however, we retain title to the inventory until purchased by the third-party. Consigned inventory, consisting of raw materials and finished goods, was $5.8 million and $7.4 million at June 30, 2012 and December 31, 2011, respectively.

Property, plant, and equipment, net	June 30, 2012	December 31, 2011
	(in thousands)	
Machinery and equipment	$269,433	$269,611
Computers and purchased software	79,471	74,885
Buildings, furniture, and improvements	141,699	140,064

Land	27,183	26,126
Construction in progress, including purchased equipment	19,212	20,687
Total cost	536,998	531,373
Accumulated depreciation	(284,913)	(268,703)
Property, plant, and equipment, net	$252,085	$262,670

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Depreciation expense	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Depreciation expense	$15,019	$16,571	$30,333	$32,505

Note 4: Intangible Assets

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

	June 30, 2012			December 31, 2011		
	Gross Assets	Accumulated Amortization	Net	Gross Assets	Accumulated Amortization	Net
	(in thousands)					
Core-developed technology	$396,671	$(313,062)	$83,609	$387,606	$(305,285)	$82,321
Customer contracts and relationships	280,894	(138,343)	142,551	278,581	(131,418)	147,163
Trademarks and trade names	70,701	(62,339)	8,362	71,854	(62,206)	9,648
Other	11,093	(10,998)	95	11,153	(10,785)	368
Total intangible assets subject to amortization	759,359	(524,742)	234,617	749,194	(509,694)	239,500
In-process research and development	19,400		19,400	—		—
Total intangible assets	$778,759	$(524,742)	$254,017	$749,194	$(509,694)	$239,500

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

	Six Months Ended June 30,	
	2012	2011
	(in thousands)	
Beginning balance, intangible assets, gross	$749,194	$759,152
Intangible assets acquired	43,400	10,297
Assets no longer in use written-off	—	(8,369)
Effect of change in exchange rates	(13,835)	40,968
Ending balance, intangible assets, gross	$778,759	$802,048

Intangible assets acquired in 2012 are based on the preliminary purchase price allocation relating to our acquisition of SmartSynch Inc. (SmartSynch) on May 1, 2012. SmartSynch's intangible assets include IPR&D, which is not amortized until such time as the associated development projects are completed. These projects are expected to be completed in the next 12 months. Refer to Note 16 for additional information regarding this acquisition. Intangible assets of our international subsidiaries are recorded in their respective functional currency; therefore, the carrying amounts of intangible assets increase or decrease, with a corresponding change in accumulated OCI, due to changes in foreign currency exchange rates.

Estimated future annual amortization expense is as follows:

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

2012 (amount remaining at June 30, 2012)	$23,458
2013	40,937
2014	36,799
2015	30,024
2016	23,723
Beyond 2016	79,676
Total intangible assets subject to amortization, net	$234,617

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Note 5: Goodwill

Effective January 1, 2012, our reporting segments were changed from two geographic operating segments, Itron North America and Itron International, to two product operating segments, Energy and Water. As a result, we reallocated the goodwill balance as of January 1, 2012 to the Electricity, Gas, and Water reporting units within these two operating segments.

The following table reflects the goodwill balance as of June 30, 2012 (in thousands):

	Total Company	Energy	Water
Balance at January 1, 2012			
Goodwill before impairment	$1,221,757	$808,601	$413,156
Accumulated impairment losses	(584,847)	(254,735)	(330,112)
Goodwill, net	636,910	553,866	83,044
Goodwill acquired	42,620	42,620	—
Effect of change in exchange rates	(15,090)	(18,466)	3,376
Balance at June 30, 2012			
Goodwill before impairment	1,201,767	812,057	389,710
Accumulated impairment losses	(537,327)	(234,037)	(303,290)
Goodwill, net	$664,440	$578,020	$86,420

Goodwill acquired in 2012 is based on the preliminary purchase price allocation relating to the SmartSynch acquisition on May 1, 2012. Refer to Note 16 for additional information regarding this acquisition.

As a result of the significant decline in the price of our shares of common stock at the end of September 2011, our aggregate market value was significantly lower than the aggregate carrying value of our net assets. As a result, we performed an impairment test of our goodwill as of September 30, 2011, and recorded total goodwill impairment charges of $584.8 million in the year ended December 31, 2011. These goodwill impairment charges were associated with our previous reporting units of Itron International Electricity and Itron International Water. The accumulated impairment losses were reallocated to our new operating segments, Energy and Water, effective January 1, 2012.

Goodwill and accumulated impairment losses associated with our international subsidiaries are recorded in their respective functional currency; therefore, the carrying amounts of these balances increase or decrease, with a corresponding change in accumulated OCI, due to changes in foreign currency exchange rates.

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Note 6: Debt

The components of our borrowings are as follows:

	June 30, 2012	December 31, 2011
	(in thousands)	
2011 credit facility:		
USD denominated term loan	$285,000	$292,502
Multicurrency revolving line of credit	170,000	160,000
Total debt	455,000	452,502
Less: Current portion of debt	15,000	15,000
Long-term debt	$440,000	$437,502

Credit Facilities

On August 5, 2011, we entered into a senior secured credit facility (2011 credit facility), which replaced the senior secured credit facility we entered into in 2007 (2007 credit facility). The 2011 credit facility consists of a $300 million U.S. dollar term loan (the term loan) and a multicurrency revolving line of credit (the revolver) with a principal amount of up to $660 million, which was increased from $500 million on April 2, 2012. Both the term loan and the revolver mature on August 8, 2016 and amounts borrowed under the revolver are classified as long-term. Amounts borrowed under the revolver during the credit facility term may be repaid and reborrowed until the revolver's maturity, at which time the revolver will terminate, and all outstanding loans, together with all accrued and unpaid interest, must be repaid. Amounts not borrowed under the revolver are subject to a commitment fee, and paid in arrears on the last day of each fiscal quarter, ranging from 0.20% to 0.40% per annum depending on our total leverage ratio as of the most recently ended fiscal quarter. Amounts repaid on the term loan may not be reborrowed. The 2011 credit facility permits us and certain of our foreign subsidiaries to borrow in U.S. dollars, euros, British pounds, or, with lender approval, other currencies readily convertible into U.S. dollars. All obligations under the 2011 credit facility are guaranteed by Itron, Inc. and material U.S. domestic subsidiaries and are secured by a pledge of substantially all of the assets of Itron, Inc. and material U.S. domestic subsidiaries, including a pledge of 100% of the capital stock of material U.S. domestic subsidiaries and up to 66% of the voting stock (100% of the non-voting stock) of their first-tier foreign subsidiaries. In addition, the obligations of any foreign subsidiary who is a foreign borrower, as defined by the 2011 credit facility, are guaranteed by the foreign subsidiary and by its direct and indirect foreign parents. The 2011 credit facility includes debt covenants, which contain certain financial ratios and place certain restrictions on the incurrence of debt, investments, and the issuance of dividends. We were in compliance with the debt covenants under the 2011 credit facility at June 30, 2012.

Scheduled principal repayments for the term loan are due quarterly in the amounts of $3.8 million through June 2013, $5.6 million from September 2013 through June 2014, $7.5 million from September 2014 through June 2016, and the remainder due at maturity on August 8, 2016. The term loan may be repaid early in whole or in part, subject to certain minimum thresholds, without penalty.

Under the 2011 credit facility, we elect applicable market interest rates for both the term loan and any outstanding revolving loans. We also pay an applicable margin, which is based on our total leverage ratio (as defined in the credit agreement). The applicable rates per annum may be based on either: (1) the LIBOR rate, plus an applicable margin, or (2) the Alternate Base Rate, plus an applicable margin. The Alternate Base Rate election is equal to the greatest of three rates: (i) the prime rate, (ii) the Federal Reserve effective rate plus 1/2 of 1%, or (iii) one month LIBOR plus 1%. At June 30, 2012, the interest rate for both the term loan and the revolver was 1.50% (the LIBOR rate plus a margin of 1.25%).

Total credit facility repayments were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
2011 credit facility term loan	$3,752	$—	$7,502	$—
2011 credit facility multicurrency revolving line of credit	50,000	—	60,000	—
2007 credit facility term loans	—	2,711	—	55,630
Total credit facility repayments	$53,752	$2,711	$67,502	$55,630

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At June 30, 2012, $170 million was outstanding under the 2011 credit facility revolver, and $50.9 million was utilized by outstanding standby letters of credit, resulting in $439.1 million available for additional borrowings.

Upon repayment of the 2007 credit facility in August 2011, unamortized prepaid debt fees of $2.4 million were written-off to interest expense. Prepaid debt fees of approximately $6.6 million in the third quarter of 2011 were capitalized associated with the 2011 credit facility, and $897,000 were capitalized associated with the increase in the revolver on April 2, 2012. Unamortized prepaid debt fees were as follows:

	June 30, 2012	December 31, 2011
	(in thousands)	
Unamortized prepaid debt fees	$6,161	$6,027

Convertible Senior Subordinated Notes

On August 1, 2011, in accordance with the terms of the convertible senior subordinated notes (convertible notes), we repurchased $184.8 million of the convertible notes at their principal amount plus accrued and unpaid interest. On September 30, 2011, we redeemed the remaining $38.8 million of the convertible notes, plus accrued and unpaid interest.

The convertible notes were separated between the liability and equity components using our estimated non-convertible debt borrowing rate at the time the convertible notes were issued, which was determined to be 7.38%. This rate also reflected the effective interest rate on the liability component for all periods during which the convertible notes were outstanding. The carrying amount of the equity component of $31.8 million is retained as a permanent component of our shareholders' equity, and no gain or loss was recognized upon derecognition of the convertible notes as the fair value of the consideration transferred to the holders equaled the fair value of the liability component.

The discount on the liability component was fully amortized by the end of the second quarter of 2011. The interest expense relating to both the contractual interest coupon and amortization of the discount on the liability component was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Contractual interest coupon	$—	$1,397	$—	$2,795
Amortization of the discount on the liability component	—	2,693	—	5,336
Total interest expense on convertible notes	$—	$4,090	$—	$8,131

Note 7: Derivative Financial Instruments

As part of our risk management strategy, we use derivative instruments to hedge certain foreign currency and interest rate exposures. Refer to Note 1, Note 13, and Note 14 for additional disclosures on our derivative instruments.

The fair values of our derivative instruments are determined using the income approach and significant other observable inputs (also known as “Level 2”). We have used observable market inputs based on the type of derivative and the nature of the underlying instrument. The key inputs used at June 30, 2012 included interest rate yield curves (swap rates and futures) and foreign exchange spot and forward rates, all of which are available in an active market. We have utilized the mid-market pricing convention for these inputs at June 30, 2012. We include the effect of our counterparty credit risk based on current published credit default swap rates when the net fair value of our derivative instruments is in a net asset position. We consider our own nonperformance risk when the net fair value of our derivative instruments is in a net liability position by discounting our derivative liabilities to reflect the potential credit risk to our counterparty through applying a current market indicative credit spread to all cash flows.

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The fair values of our derivative instruments at June 30, 2012 and December 31, 2011 are as follows:

	Balance Sheet Location	Fair Value June 30, 2012	December 31, 2011
		(in thousands)	
Asset Derivatives			
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current assets	$762	$241
Liability Derivatives			
Derivatives designated as hedging instruments under ASC 815-20			
Interest rate swap contracts	Other long-term obligations	$1,365	$—
Derivatives not designated as hedging instruments under ASC 815-20			
Foreign exchange forward contracts	Other current liabilities	730	222
Total liability derivatives		$2,095	$222

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

	2012	2011
	(in thousands)	
Net unrealized loss on hedging instruments at January 1,	$(14,380)	$(10,034)
Unrealized gain (loss) on derivative instruments	(849)	(164)
Unrealized gain (loss) on a nonderivative net investment hedging instrument	—	(9,262)
Realized (gains) losses reclassified into net income (loss)	—	2,774
Net unrealized loss on hedging instruments at June 30,	$(15,229)	$(16,686)

Following the termination of our net investment hedge in August 2011, the net derivative loss of $14.4 million will remain in accumulated OCI until such time when earnings are impacted by a sale or liquidation of the associated foreign operation.

Cash Flow Hedges

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

In May 2012, we entered into six forward starting pay-fixed receive one-month LIBOR interest rate swaps. The interest rate swaps convert $200 million of our LIBOR based debt from a floating LIBOR interest rate to a fixed interest rate of 1.00% (excluding the applicable margin on the debt) and are effective July 31, 2013 to August 8, 2016. The cash flow hedges are expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk through the term of the hedge. Consequently, effective changes in the fair value of the interest rate swaps are recorded as a component of OCI and will be recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedges will be recognized as adjustments to interest expense. The amount of net losses expected to be reclassified into earnings in the next 12 months is $0 due to the effective date of the swaps of July 31, 2013, which is beyond 12 months. At June 30, 2012, our LIBOR based debt balance was $455.0 million.

In 2007, we entered into a pay fixed 6.59% receive three-month Euro Interbank Offered Rate (EURIBOR), plus 2%, amortizing interest rate swap to convert a significant portion of our euro denominated variable-rate term loan to fixed-rate debt, plus or minus the variance in the applicable margin from 2%, through December 31, 2012. The objective of this swap was to protect us from increases in the EURIBOR base borrowing rates. The swaps did not protect us from changes to the applicable margin under our credit agreement. Throughout the duration of the hedging relationship, this cash flow hedge was expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk. Consequently, effective changes in the fair value of the interest rate swap were recorded as a component of OCI and were recognized in earnings when the hedged item affected earnings. The amounts paid or received on the hedge were recognized as adjustments to interest expense. In August 2011, we repaid our 2007 credit facility, which included the euro-denominated term loan. In conjunction with the debt repayment, we paid $2.9 million to

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terminate the related interest rate swap, and the accumulated loss in OCI was reclassified to interest expense.

In 2010, we entered into two interest rate swaps with one-year terms, which each converted $100 million of our U.S. dollar term loan from a floating LIBOR interest rate to fixed interest rates of 2.11% and 2.15%, respectively. These swaps expired on June 30, 2011 and did not include the additional interest rate margin applicable to our term debt.

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

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

Derivatives in ASC 815-20 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)			Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)		
			Location	Amount		Location	Amount	
	2012	2011		2012	2011		2012	2011
	(in thousands)			(in thousands)			(in thousands)	
Three Months Ended June 30,								
Interest rate swap contracts	$ (1,365)	$ (2,149)	Interest expense	$ —	$ (1,788)	Interest expense	$—	$(31)
Six Months Ended June 30,								
Interest rate swap contracts	$ (1,365)	$ (4,477)	Interest expense	$ —	$ (4,171)	Interest expense	$—	$(80)

Net Investment Hedge
We are exposed to foreign exchange risk through our international subsidiaries. As a result of our acquisition of an international company in 2007, we entered into a euro denominated term loan, which exposed us to fluctuations in the euro foreign exchange rate. Therefore, we designated this foreign currency denominated term loan as a hedge of our net investment in international operations. The non-functional currency term loan was revalued into U.S. dollars at each balance sheet date, and the changes in value associated with currency fluctuations were recorded as adjustments to long-term debt with offsetting gains and losses recorded in OCI. The loan was repaid in full in August 2011 as part of our repayment of the 2007 credit facility. The net derivative loss will remain in accumulated OCI until such time when earnings are impacted by a sale or liquidation of the associated foreign operation.

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

Nonderivative Financial Instruments in ASC 815-20 Net Investment Hedging Relationships	Euro Denominated Term Loan Designated as a Hedge of Our Net Investment in International Operations			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Gain (loss) recognized in OCI on derivative				

(Effective Portion)				
Before tax	$—	$(2,343)	$—	$(14,923)
Net of tax	$—	$(1,452)	$—	$(9,262)

Derivatives Not Designated as Hedging Relationships

We are also exposed to foreign exchange risk when we enter into non-functional currency transactions, both intercompany and third-party. At each period-end, non-functional currency monetary assets and liabilities are revalued with the change recorded to other income and expense. We enter into monthly foreign exchange forward contracts (a total of 293 contracts were entered into during the six months ended June 30, 2012), which are not designated for hedge accounting, with the intent to reduce earnings volatility associated with certain of these balances. The notional amounts of the contracts ranged from $120,000 to $51 million, offsetting our exposures from the euro, British pound, Canadian dollar, Australian dollar, Brazilian real, and various other currencies.

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

Derivatives Not Designated as Hedging Instrument under ASC 815-20	Gain (Loss) Recognized on Derivatives in Other Income (Expense)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Foreign exchange forward contracts	$(244)	$(1,259)	$(421)	$(3,341)

Note 8: Defined Benefit Pension Plans

We sponsor both funded and unfunded defined benefit pension plans for our international employees, primarily in Germany, France, Italy, Indonesia, and Spain, offering death and disability, retirement, and special termination benefits. The defined benefit obligation is calculated annually by using the projected unit credit method. The measurement date for the pension plans was December 31, 2011.

Our defined benefit pension plans are denominated in the functional currencies of the respective countries in which the plans are sponsored; therefore, the balances increase or decrease, with a corresponding change in OCI, due to changes in foreign currency exchange rates. Amounts recognized on the Consolidated Balance Sheets consist of:

	June 30, 2012	December 31, 2011
	(in thousands)	
Plan assets in other long-term assets	$(452)	$(449)
Current portion of pension plan liability in wages and benefits payable	2,608	2,621
Long-term portion of pension plan liability	60,822	62,449
Net pension plan benefit liability	$62,978	$64,621

Our asset investment strategy focuses on maintaining a portfolio using primarily insurance funds, which are accounted for as investments and measured at fair value, in order to achieve our long-term investment objectives on a risk adjusted basis. Our general funding policy for these qualified pension plans is to contribute amounts sufficient to satisfy regulatory funding standards of the respective countries for each plan. We contributed $34,000 and $355,000 to the defined benefit pension plans for the three and six months ended June 30, 2012, and $37,000 and $391,000 for the three and six months ended June 30, 2011, respectively. The timing of when contributions are made can vary by plan and from year to year. For 2012, assuming that actual plan asset returns are consistent with our expected rate of return, and that interest rates remain constant, we expect to contribute approximately $485,000 to our defined benefit pension plans. We contributed $520,000 to the defined benefit pension plans for the year ended December 31, 2011.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Service cost	$676	$601	$1,414	$1,218
Interest cost	909	969	1,835	1,886
Expected return on plan assets	(82)	(83)	(167)	(163)
Amortization of actuarial net loss (gain)	2	14	4	28
Amortization of unrecognized prior service costs	17	19	34	37
Net periodic benefit cost	$1,522	$1,520	$3,120	$3,006

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Note 9: Stock-Based Compensation

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Stock options	$337	$511	$609	$1,544
Restricted stock units	4,375	3,853	7,891	7,404
Unrestricted stock awards	205	15	410	190
ESPP	141	164		