BADGER METER INC
Form 10-Q
October 26, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended September 30, 2010
BADGER METER, INC.
4545 W. Brown Deer Road
Milwaukee, Wisconsin 53223
(414) 355-0400
A Wisconsin Corporation
IRS Employer Identification No. 39-0143280
Commission File No. 001-06706

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 þ No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

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 definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

As of October 15, 2010, there were 15,034,736 shares of Common Stock outstanding with a par value of $1 per share.

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Special Note Regarding Forward Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q, as well as other information provided from time to time by Badger Meter, Inc. (the Company) or its employees, may contain forward looking statements that involve risks and uncertainties that could cause actual results to differ materially from those in the forward looking statements. The words anticipate, believe, estimate, expect, think, should, could and objective or simila are intended to identify forward looking statements. All such forward looking statements are based on the Company s then current views and assumptions and involve risks and uncertainties that include, among other things:

- the continued shift in the Company s business from lower cost, manually read meters toward more expensive, value-added automatic meter reading (AMR) systems and advanced metering infrastructure (AMI) systems;
- the success or failure of newer Company products;
- changes in competitive pricing and bids in both the domestic and foreign marketplaces, and particularly in continued intense price competition on government bid contracts for lower cost, manually read meters;
- the actions (or lack thereof) of the Company s competitors;
- changes in the Company s relationships with its alliance partners, primarily its alliance partners that provide AMR/AMI connectivity solutions, and particularly those that sell products that do or may compete with the Company s products;
- changes in the general health of the United States and foreign economies, including to some extent such things as the length and severity of global economic downturns, the ability of municipal water utility customers to authorize and finance purchases of the Company s products, the Company s ability to obtain financing, housing starts in the United States, and overall industrial activity;
- the timing and impact of government programs to stimulate national and global economies;
- changes in the cost and/or availability of needed raw materials and parts, such as volatility in the cost of brass castings as a result of fluctuations in commodity prices, particularly for copper and scrap metal at the supplier level, foreign-sourced electronic components as a result of currency exchange fluctuations and/or lead times, and plastic resin as a result of changes in petroleum and natural gas prices;
- the Company s expanded role as a prime contractor for providing complete AMR/AMI systems to governmental entities, which brings with it added risks, including but not limited to, the Company s responsibility for subcontractor performance, additional costs and expenses if the Company and its subcontractors fail to meet the timetable agreed to with the governmental entity, and the Company s expanded warranty and performance obligations;
- the Company s ability to successfully integrate acquired businesses or products;
- changes in foreign economic conditions, particularly currency fluctuations in the United States dollar, the euro and the Mexican peso;
- the loss of certain single-source suppliers; and,
- changes in laws and regulations, particularly laws dealing with the use of lead (which can be used in the manufacture of certain meters incorporating brass housings) and the United States Federal Communications Commission rules affecting the use and/or licensing of radio frequencies necessary for AMR/AMI products.

All of these factors are beyond the Company s control to varying degrees. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward looking statements and are cautioned not to place undue reliance on such forward looking statements. The forward looking statements made in this document are made only as of the date of this document and the Company assumes no obligation, and disclaims any obligation, to update any such forward looking statements to reflect subsequent events or circumstances.

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Part I Financial Information

Item 1 Financial Statements

BADGER METER, INC.
Consolidated Condensed Balance Sheets

	September 30, 2010 (Unaudited)	December 31, 2009
	(In thousands)	
Assets		
Current assets:		
Cash	$ 2,674	$ 13,329
Receivables	53,415	35,809
Inventories:		
Finished goods	9,581	8,960
Work in process	13,261	10,372
Raw materials	18,429	13,152
Total inventories	41,271	32,484
Prepaid expenses and other current assets	2,619	2,488
Deferred income taxes	2,583	2,570
Total current assets	102,562	86,680
Property, plant and equipment, at cost	141,812	138,123
Less accumulated depreciation	(76,424)	(75,252)
Net property, plant and equipment	65,388	62,871
Intangible assets, at cost less accumulated amortization	34,712	23,603
Other assets	7,373	5,845
Deferred income taxes	2,180	5,059
Goodwill	9,000	6,958
Total assets	$ 221,215	$ 191,016
Liabilities and shareholders equity		
Current liabilities:		
Short-term debt	$ 13,062	$ 2,574
Current portion of long-term debt		5,429
Payables	14,219	10,773

Accrued compensation and employee benefits	7,420	6,071
Warranty and after-sale costs	1,058	907
Income and other taxes	7,534	507
Total current liabilities	43,293	26,261
Other long-term liabilities	2,355	2,338
Accrued non-pension postretirement benefits	6,044	5,949
Other accrued employee benefits	7,145	12,007
Commitments and contingencies (Note 7)		
Shareholders equity:		
Common stock	21,241	21,210
Capital in excess of par value	36,467	35,221
Reinvested earnings	151,943	135,225
Accumulated other comprehensive loss	(13,848)	(14,585)
Less: Employee benefit stock	(1,536)	(585)
Treasury stock, at cost	(31,889)	(32,025)
Total shareholders equity	162,378	144,461
Total liabilities and shareholders equity	$ 221,215	$ 191,016

See accompanying notes to consolidated condensed financial statements.

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BADGER METER, INC.
Consolidated Condensed Statements of Operations

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	(In thousands except share and per share amounts)			
	2010	2009	2010	2009
Net sales	$ 75,702	$ 60,814	$ 211,791	$ 193,901
Cost of sales	47,748	37,089	133,605	117,403
Gross margin	27,954	23,725	78,186	76,498
Selling, engineering and administration	14,518	13,057	43,022	41,705
Operating earnings	13,436	10,668	35,164	34,793
Interest expense (income)	95	(962)	275	(255)
Earnings from continuing operations before income taxes	13,341	11,630	34,889	35,048
Provision for income taxes	4,318	4,665	12,485	13,353
Earnings from continuing operations	9,023	6,965	22,404	21,695
Earnings from discontinued operations net of income taxes		7,390		7,390
Net earnings	$ 9,023	$ 14,355	$ 22,404	$ 29,085
Per share amounts:				
Earnings per share:				
Basic from continuing operations	$ 0.61	$ 0.47	$ 1.50	$ 1.47
Basic from discontinued operations	$	$ 0.50	$	$ 0.50
Total basic	$ 0.61	$ 0.97	$ 1.50	$ 1.97

Diluted from continuing operations	$	0.60	$	0.47	$	1.49	$	1.45
Diluted from discontinued operations	$		$	0.49	$		$	0.50
Total diluted	$	0.60	$	0.96	$	1.49	$	1.95
Dividends declared Common stock	$	0.14	$	0.12	$	0.38	$	0.34
Shares used in computation of earnings per share:								
Basic		14,910,497		14,830,871		14,897,901		14,774,985
Impact of dilutive securities		96,068		130,633		101,285		159,964
Diluted		15,006,565		14,961,504		14,999,186		14,934,949

See accompanying notes to consolidated condensed financial statements.

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BADGER METER, INC.
Consolidated Condensed Statements of Cash Flows

	Nine Months Ended September 30, (Unaudited) (In thousands)	
	2010	2009
Operating activities:		
Net earnings	$ 22,404	$ 29,085
Adjustments to reconcile net earnings to net cash provided by (used for) operations:		
Depreciation	5,211	5,309
Amortization	1,213	1,070
Gain on legal settlement	(740)	
Deferred income taxes	2,158	3,908
Previously unrecognized tax benefits, including interest		(8,599)
Noncurrent employee benefits	2,399	2,746
Contribution to pension plan	(4,700)	(10,100)
Stock-based compensation expense	918	811
Changes in:		
Receivables	(16,964)	208
Inventories	(7,858)	3,162
Prepaid expenses and other current assets	(128)	(744)
Liabilities other than debt	9,751	(2,269)
Total adjustments	(8,740)	(4,498)
Net cash provided by operations	13,664	24,587
Investing activities:		
Property, plant and equipment expenditures	(6,962)	(6,008)
Acquisition, net of cash acquired	(7,280)	
Acquisition of intangible asset	(8,028)	
Investment in emerging technology company	(1,500)	
Other net	(62)	(443)
Net cash used for investing activities	(23,832)	(6,451)
Financing activities:		
Net increase (decrease) in short-term debt	10,607	(3,346)
Repayments of long-term debt	(5,429)	(7,284)
Dividends paid	(5,684)	(5,039)
Proceeds from exercise of stock options	228	1,023
Tax benefit on stock options	135	989
Employee benefit stock purchase, net	(1,000)	
Issuance of treasury stock	121	136

Net cash used for financing activities	(1,022)	(13,521)
Effect of foreign exchange rates on cash	535	88
Increase (decrease) in cash	(10,655)	4,703
Cash beginning of period	13,329	6,217
Cash end of period	$ 2,674	$ 10,920

See accompanying notes to consolidated condensed financial statements.

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BADGER METER, INC.

Notes to Unaudited Consolidated Condensed Financial Statements

Note 1 Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated condensed financial statements of Badger Meter, Inc. (the Company) contain all adjustments (consisting only of normal recurring accruals except as otherwise discussed) necessary to present fairly the Company s consolidated condensed financial position at September 30, 2010, results of operations for the three- and nine-month periods ended September 30, 2010 and 2009, and cash flows for the nine-month periods ended September 30, 2010 and 2009. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Certain reclassifications have been made to the 2009 consolidated condensed financial statements to conform to the 2010 presentation.

Note 2 Additional Balance Sheet Information

The consolidated condensed balance sheet at December 31, 2009 was derived from amounts included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009. Refer to the footnotes to the financial statements included in that report for a description of the Company s accounting policies and for additional details of the Company s financial condition. The details in those notes have not changed except as discussed below and as a result of normal adjustments in the interim.

Warranty and After-Sale Costs

The Company estimates and records provisions for warranties and other after-sale costs in the period in which the sale is recorded, based on a lag factor and historical warranty claim experience. After-sale costs represent a variety of activities outside of the written warranty policy, such as investigation of unanticipated problems after the customer has installed the product, or problems caused by water quality issues. Changes in the Company s warranty and after-sale costs reserve for the nine-month periods ended September 30, 2010 and 2009 were as follows:

(In thousands)	Balance at beginning of year	Net additions charged to earnings	Costs incurred and adjustments	Balance at September 30
2010	$ 907	$ 671	$ (520)	$ 1,058
2009	$ 1,327	$ 512	$ (671)	$ 1,168

Recent Pronouncements

In March 2010, the Patient Protection and Affordable Care Act of the Health Care and Education Act of 2010 became law. The Company continues to evaluate the impact, if any, on its future operating results.

Note 3 Employee Benefit Plans

The Company maintains a non-contributory defined benefit pension plan for its domestic employees and a non-contributory postretirement plan that provides medical benefits for certain domestic retirees and eligible dependents. In the third quarter of 2010, the Company decided to freeze the pension plan for its non-union employees and form a new feature within the Badger Meter Employee Savings and Stock Ownership Plan (ESSOP) effective for calendar year 2011 in which the employee will earn a similar amount. This action resulted in a freeze of future service credits for these employees, a small decrease in the current year s pension expense and an immaterial amount of curtailment income at September 30, 2010.

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The following table sets forth the components of net periodic benefit cost for the three months ended September 30, 2010 and 2009 based on December 31, 2009 and 2008 actuarial measurement dates, respectively:

(In thousands)	Pension benefits 2010	Pension benefits 2009	Other postretirement benefits 2010	Other postretirement benefits 2009
Service cost benefits earned during the year	$ 447	$ 450	$ 32	$ 32
Interest cost on projected benefit obligations	496	748	81	102
Expected return on plan assets	(864)	(846)		
Amortization of prior service cost (credit)	50	(16)	42	48
Amortization of net loss	437	262		
Net periodic benefit cost	$ 566	$ 598	$ 155	$ 182

The following table sets forth the components of net periodic benefit cost for the nine months ended September 30, 2010 and 2009 based on December 31, 2009 and 2008 actuarial measurement dates, respectively:

(In thousands)	Pension benefits 2010	Pension benefits 2009	Other postretirement benefits 2010	Other postretirement benefits 2009
Service cost benefits earned during the year	$ 1,393	$ 1,353	$ 104	$ 93
Interest cost on projected benefit obligations	1,855	2,246	254	295
Expected return on plan assets	(2,767)	(2,540)		
Amortization of prior service cost (credit)	50	(48)	124	140
Amortization of net loss	1,217	785		
Net periodic benefit cost	$ 1,748	$ 1,796	$ 482	$ 528

The Company previously disclosed in its financial statements for the year ended December 31, 2009 that it did not expect to make a contribution to its pension plan for the 2010 calendar year. While no contributions were required in calendar year 2010, the Company made a $4.7 million contribution in September to fully fund the plan based on current regulations. The Company believes no additional contributions will be required for 2010.

The Company disclosed in its financial statements for the year ended December 31, 2009 that it estimated it would pay $0.5 million in other postretirement benefits in 2010 based on actuarial estimates. As of September 30, 2010, $0.3 million of such benefits were paid. The Company believes that its estimated payments for the full year may be somewhat less than the prior full-year estimate. However, such estimates contain inherent uncertainties because cash payments can vary significantly depending on the timing of postretirement medical claims and the collection of the retiree s portion of certain costs. Note that the amount of benefits paid in calendar year 2010 will not impact the expense for postretirement benefits for 2010.

Note 4 Guarantees

Prior to September 2010, the Company guaranteed the outstanding debt of the ESSOP that was recorded in the current portion of long-term debt, offset by a similar amount of unearned compensation that was recorded as a reduction of shareholders equity. The loan amount was collateralized by shares of the Company s Common Stock. A payment of $49,000 was made in the first quarter of 2010 that reduced the debt and the corresponding employee benefit stock balance included in shareholders equity.

In September 2010, the Company made a $1.5 million loan to the ESSOP in exchange for the ESSOP agreeing to extend the program through December 31, 2020. The ESSOP was previously set to expire on December 31, 2011. The loan amount is collateralized by shares of the Company s Common Stock. The ESSOP used $0.5 million to pay down its existing debt to a bank, which correspondingly eliminated the $0.5 of debt reflected on the Company s balance sheet as well as the Company s guarantee of the debt. The net result on the Company s balance sheet at September 30, 2010 was $1.5 million recorded in employee benefit stock.

Note 5 Comprehensive Income (Loss)

Comprehensive income for the three-month periods ended September 30, 2010 and 2009 was $10.2 million and $14.8 million, respectively. Comprehensive income for the nine-month periods ended September 30, 2010 and 2009 was $23.1 million and $29.9 million, respectively.

Components of accumulated other comprehensive loss are as follows:

(In thousands)		September 30, 2010		December 31, 2009
Cumulative foreign currency translation adjustment	$	1,566	$	1,739
Unrecognized pension and postretirement benefit plan liabilities (net of tax of $9.9 million and $10.4 million for 2010 and 2009, respectively)		(15,414)		(16,324)
Accumulated other comprehensive loss	$	(13,848)	$	(14,585)

Note 6 Acquisition and Investments

On April 1, 2010, the Company purchased Cox Instruments, LLC, of Scottsdale, Arizona, and its subsidiary Flow Dynamics, Inc. for $7.8 million. Cox Instruments and Flow Dynamics manufacture and market precision high performance flow meters that are used in demanding applications such as aerospace, custody transfer and flow measurement test stands. The Company merged the two entities into a wholly-owned subsidiary named Cox Flow Measurement, Inc. on April 1, 2010 and will treat it as a product line for management purposes. The Company s preliminary purchase price allocation at September 30, 2010 included $0.6 million of cash, plus approximately $0.7 million of accounts receivable, $1.1 million of inventory, $0.3 million of fixed assets, $4.3 million of intangibles, $2.0 million of goodwill and $1.2 million of liabilities.

The acquisition was accounted for under the purchase method, and accordingly, the results of operations are included in the Company s financial statements from the date of acquisition. The acquisition did not have a material impact on the Company s consolidated financial statements or the notes thereto.

In September 2010, the Company purchased a license to manufacture and sell a key component of the Company s line of turbine meters for $8.0 million. This amount is included in Intangible Assets in the accompanying Consolidated Condensed Balance Sheets.

In June 2010, the Company invested $1.5 million to purchase a small ownership percentage in an emerging technology company. This amount is included in Other Assets in the accompanying Consolidated Condensed Balance Sheets.

Note 7 Contingencies, Litigation and Commitments

In the normal course of business, the Company is named in legal proceedings. There are currently no material legal proceedings pending with respect to the Company. The more significant legal proceedings are discussed below.

The Company is subject to contingencies related to environmental laws and regulations. The Company is named as one of many potentially responsible parties in two landfill lawsuits and is in the process of resolving a claim related to a parcel of land adjoining the Company s property. The landfill sites are impacted by the Federal Comprehensive Environmental Response, Compensation and Liability Act and other environmental laws and regulations. At this time, the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the Company s financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. Regarding the landfill sites, this belief is based on the Company s assessment of its limited past involvement with these landfill sites as well as the substantial involvement of and government focus on other named third parties with these landfill sites. However, due to the inherent uncertainties of such proceedings, the Company cannot predict the ultimate outcome of any of these matters. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2009 and the first three quarters of 2010 were not material.

Like other companies in recent years, the Company has been named as a defendant in numerous multi-claimant/multi-defendant lawsuits alleging personal injury as a result of exposure to asbestos, manufactured by third parties, and integrated into or sold with a very limited number of the Company s products. The Company is vigorously defending itself against these claims. Although it is not possible to predict the ultimate outcome of these matters, the Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company s financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. This belief is based in part on the fact that no claimant has proven or substantially demonstrated asbestos exposure caused by products manufactured or sold by the Company and that a number of cases have been voluntarily dismissed.

The Company relies on single suppliers for certain castings and components in several of its product lines. Although alternate sources of supply exist for these items, a loss of certain suppliers could temporarily disrupt the Company s operations in the short term. The Company attempts to mitigate this risk by working closely with key suppliers, purchasing minimal amounts from alternative suppliers and by purchasing business interruption insurance where appropriate.

The Company reevaluates its exposures on a periodic basis and makes adjustments to reserves as appropriate.

Note 8 Subsequent Events

The Company evaluated subsequent events in order to identify conditions that existed at the date of the balance sheet as well as conditions that arose after the balance sheet date but before the financial statements were issued. The effects of conditions that existed at the date of the balance sheet date are recognized in the financial statements. Events and conditions arising after the balance sheet date but before the financial statements are issued are evaluated to determine if disclosure is required to keep the financial statements from being misleading. To the extent such events and conditions exist, disclosures are made regarding the nature and estimated financial effects of such events and conditions. For purposes of preparing the accompanying consolidated financial statements and the notes to these financial statements, the Company evaluated subsequent events through the date the accompanying financial statements were issued.

In October 2010, the Company renewed its principal line of credit (increasing it from $35.0 million to $50.0 million) for one year. The Company believes that its operating cash flows, available borrowing capacity, and its ability to raise capital provide adequate resources to fund ongoing operating requirements, future capital expenditures and the development of new products. The Company had $32.5 million of unused credit lines available at September 30, 2010.

Note 9 Fair Value Measurements of Financial Instruments

The carrying amounts of cash, receivables and payables in the financial statements approximate fair value. Short-term debt is comprised of notes payable drawn against the Company s lines of credit and commercial paper. Because of the short-term nature of these instruments, the carrying value approximates the fair value. Included in other assets are insurance policies on various individuals that were associated with the Company. The carrying amounts of these insurance policies approximate their fair value.

Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

Business Description and Overview

Badger Meter s core competency is flow measurement solutions. The Company is a leading manufacturer and marketer of products incorporating liquid flow measurement and control technologies developed both internally and with other technology companies. Its products are used in a wide variety of applications, including water, oil and chemicals. The Company s product lines fall into two categories: water applications and specialty applications.

Water applications, the largest category by sales volume, include the sale of water meters and related technologies and services used by water utilities as the basis for generating water and wastewater revenues. The market for the Company s water meter products is North America, primarily the United States, because the meters are designed and manufactured to conform to standards promulgated by the American Water Works Association. The Company s products are also sold for other water purposes including irrigation, water reclamation and industrial process applications.

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Specialty applications include the sale of meters and related technologies and services for measuring a wide variety of fluids in industries such as food and beverage, pharmaceutical production, petroleum, heating, ventilating and air conditioning (HVAC), and measuring and dispensing automotive fluids. It also includes the sale of radio technology to natural gas utilities for installation on their gas meters.

The sales of water meters and related technologies and services for water applications constitute a majority of the Company s sales and are commonly referred to as sales of residential or commercial meters, the latter referring to larger sizes of meters.

Residential and commercial water meters are generally classified as either manually read meters or remotely read meters via radio technology. A manually read meter consists of the water meter and a register that gives a visual display of the meter reading. Meters equipped with radio transmitters use encoder registers to convert the measurement data from the meter to a digital format which is then transmitted via radio frequency to a receiver that collects and formats the data appropriately for a water utility s billing system. Drive-by systems, referred to as automatic meter reading (AMR) systems, have been the primary technology deployed by water utilities over the past two decades, providing accurate and cost-effective billing data. In an AMR system, a vehicle equipped for meter reading purposes, including a radio receiver, computer and reading software, collects meter reading data.

Fixed network advanced metering infrastructure (AMI) systems continue to build interest among water utilities. These systems do not rely on a drive-by data collector, but rather incorporate a network of permanent data collectors or gateway receivers that are always active or listening for the radio transmission from the utility s meters. Not only do AMI systems eliminate the need for utility personnel to drive through service territories to collect meter reading data, but they have the ability to provide the utility with more frequent and diverse meter reading data at specified intervals.

The Company s net sales and corresponding net earnings depend on unit volume and mix of products, with the Company generally earning higher margins on meters equipped with AMR or AMI technology. In addition to selling its proprietary AMR/AMI products, including the ORION® AMR technology and the GALAXY® AMI system, the Company also remarkets the Itron® AMR product under a license and distribution agreement. The Company s proprietary AMR/AMI products generally result in higher margins than the remarketed, non-proprietary AMR/AMI products. The Company also sells registers and radios separately to customers who wish to upgrade their existing meters in the field.

The proprietary ORION receiver technology has been licensed to other technology providers, including those providing AMR/AMI products that communicate over power lines, broadband networks, and proprietary radio frequency networks, allowing ORION a distinct connectivity advantage in the AMR/AMI market. In addition, the ORION universal gateway receiver enables ORION data to be transmitted to a utility customer over a variety of public wireless networks for strategic deployments, such as monitoring large commercial users.

Water meter product sales, including AMR/AMI product sales, derive from customers water meter replacement requirements along with the adoption and deployment of new technology. To a much lesser extent, housing starts also contribute to the base of new product sales. Over the last decade, there has been a growing trend in the conversion from manually read water meters to AMR/AMI technology. This conversion rate is accelerating and contributing to an increased base of business available to meter and AMR/AMI manufacturers. The Company estimates that less than 30% of water meters installed in the United States have been converted to AMR/AMI systems. A key component of the Company s strategy is to fulfill customers metering expectations and requirements with its proprietary meter reading systems or other systems available through its alliance partners in the marketplace.

The specialty application products serve niche flow measurement and control applications across a broad industrial spectrum. Specialized communication protocols that control the entire flow measurement process drive the market. The Company s specific flow measurement and control applications and technologies serve the broad flow measurement market.

Business Trends

Increasingly, the electric utility industry relies on AMI technology for two-way communication to monitor and control electrical devices at the customer s site. Although the Company does not sell products for electric market applications, the trend toward AMI is now affecting the markets in which the Company does participate, particularly the water utility market. Specifically, AMI enables water utilities to capture interval readings from each meter daily.

While two-way communication is currently limited in water AMI, utilities are contemplating two-way network benefits. As noted above, the Company markets the ORION AMR products as well as the GALAXY AMI products. The Company sells either product in response to customer requirements. Since both products have comparable margins, any acceleration or slowdown in the trend toward AMI is not expected to have a significant impact on the Company s net sales related to AMR and AMI technology.

There are approximately 53,000 water utilities in the United States and the Company estimates that less than 30% of the installed water meter base have converted to an AMR or AMI technology. Although there is growing interest in AMI communication by water utilities, the vast majority of utilities installing AMR or AMI technology continue to select AMR technologies for their applications. The Company s ORION technology has experienced rapid acceptance in the United States as an increasing number of water utilities have selected ORION as their AMR solution. The Company anticipates that even with growing interest in AMI, AMR will continue to be the primary product of choice for a number of years. For many water utilities, AMR technology is simply the most cost-effective solution available.

Revenue and Product Mix

Prior to the Company s introduction of its own proprietary AMR products (ORION), Itron water utility-related products were a dominant AMR contributor to the Company s results. Itron products are sold under an agreement between the Company and Itron, Inc. that is scheduled to expire in early 2011 and is expected to be renewed. The Company s ORION products directly compete with Itron water AMR products. In recent years, many of the Company s customers have selected ORION products over Itron products. While ORION sales were 2.4 times greater than those of the Itron licensed products for the first nine months of 2010 and 2.3 times greater for all of 2009, the Company expects that the Itron products will remain a significant component of sales to utilities. Continuing sales in both product lines underscores the continued acceptance of AMR technology by water utilities and affirms the Company s strategy of selling Itron products in addition to its own proprietary products.

As the industry continues to evolve, there may be additional opportunities for revenue enhancement. For instance, in recent years the Company has been asked to oversee and perform field installation of its products for selected customers. The Company assumes the role of general contractor, hiring an installation subcontractor and supervising its work. The Company also sells extended service programs for the technology sold with its products. The extended service programs provide additional services beyond the standard warranty. In addition, the Company sells ORION radio technology to natural gas utilities for installation on their gas meters. Revenues from such products and services are not yet significant and the Company is uncertain of the potential growth achievable for such products and services in future periods.

Acquisition and Investments

On April 1, 2010, the Company purchased Cox Instruments, LLC, of Scottsdale, Arizona, and its subsidiary Flow Dynamics, Inc. for $7.8 million. Cox Instruments and Flow Dynamics manufacture and market precision high performance flow meters that are used in demanding applications such as aerospace, custody transfer and flow measurement test stands. The Company merged the two entities into a wholly-owned subsidiary named Cox Flow Measurement, Inc. on April 1, 2010 and will treat it as a product line for management purposes. The Company s preliminary purchase price allocation at September 30, 2010 included $0.6 million of cash, plus approximately $0.7 million of accounts receivable, $1.1 million of inventory, $0.3 million of fixed assets, $4.3 million of intangibles, $2.0 million of goodwill and $1.2 million of liabilities.

The acquisition was accounted for under the purchase method, and accordingly, the results of operations are included in the Company s financial statements from the date of acquisition. The acquisition did not have a material impact on the Company s consolidated financial statements or the notes thereto.

In September 2010, the Company purchased a license to manufacture and sell a key component of the Company s line of turbine meters for $8.0 million. This amount is included in Intangible Assets in the accompanying Consolidated Condensed Balance Sheets.

In June 2010, the Company invested $1.5 million to purchase a small ownership percentage in an emerging technology company. This amount is included in Other Assets in the accompanying Consolidated Condensed Balance Sheets.

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Results of Operations   Three Months Ended September 30, 2010

The Company s net sales for the three months ended September 30, 2010 increased $14.9 million, or 24.5%, to $75.7 million from $60.8 million in the same period in 2009. The increase was due to higher sales in most of the Company s products lines as well as the addition of the Cox Flow Measurement product line.

Water application products represented 83.7% of sales for the three months ended September 30, 2010 compared to 89.4% for the same period in 2009. Sales of water application products increased $9.0 million, or 16.5%, to $63.4 million during the third quarter of 2010 compared to $54.4 million in the same period in 2009. The increase was due to higher volumes of meters, both manual and those sold with AMR/AMI technology, and higher prices. Sales of the Company s ORION AMR technology products increased 18.4% during the third quarter of 2010 from the third quarter of 2009, while sales of the Itron related products increased 25.5%. In the most recent period, ORION related products outsold Itron related products by a ratio of 1.8 to 1. Sales of manually read meters increased by 10.6% during the third quarter of 2010 over the same period in the prior year. The Company attributes a portion of the overall increases to higher levels of demand due to the elimination of the uncertainly over the release of U.S. government stimulus funds earlier in the year. Commercial sales were relatively flat for the third quarter of 2010 compared to the third quarter of 2009.

Specialty application products represented 16.3% of sales for the three month period ended September 30, 2010 compared to 10.6% for the same period in 2009. These sales increased nearly $5.9 million, or 92.2%, to $12.3 million from $6.4 million in the third quarter of 2009. The increases were driven by the addition of the Cox Flow Measurement product line, significantly higher sales of radios for natural gas meters and higher sales volumes in most of the other specialty application product lines over the third quarter 2009 levels, which were low due to weak economic conditions.

The gross margin as a percentage of net sales was 36.9% in the third quarter of 2010 compared to 39.0% in the third quarter of 2009. The decline was due to increased costs of meter castings which fluctuate with the metals market, particularly copper, and higher costs associated with meeting certain Made in America requirements for stimulus fund related purchases. These cost increases were offset somewhat by higher prices charged for certain of the Company s products, favorable currency exchange rates on foreign-sourced electronic components, product mix and more efficient plant utilization.

Selling, engineering and administration expenses increased $1.5 million, or 11.2%, in the third quarter of 2010 compared to the third quarter of 2009. The increase was due to higher expenses associated with the Cox Flow Measurement acquisition, employee incentive programs, bad debt experience and increased labor costs due to additional personnel to strengthen the Company s customer support functions. Expenses are also affected by normal inflationary increases, offset by continuing cost controls.

Interest expense for the third quarter of 2010 was $0.1 million versus interest income of $1.0 million in the third quarter of 2009 which included a reversal of $1.2 million of interest expense related to the favorable resolution of previously unrecognized tax benefits. Interest expense on the Company s debt continued to decline as cash generated from operations was used to lower the average debt balances.

The provision for income taxes as a percentage of earnings from continuing operations before income taxes for the third quarter of 2010 was 32.4% compared to 40.1% in the third quarter of 2009. The primary reason for the decrease was a revised estimate of overall lower state income taxes for 2010 as well as the adjustments necessary to estimated deductions upon filing the Company s tax returns.

As a result of the above mentioned items, earnings from continuing operations for the three months ended September 30, 2010 were $9.0 million compared to $7.0 million in the three month period ended September 30, 2009. On a diluted basis, earnings per share from continuing operations were $0.60 for the third quarter of 2010 compared to $0.47 for the same period in 2009.

The third quarter of 2009 results also included recognition of previously unrecognized tax benefits for certain deductions that were taken on prior tax returns related to the 2006 shutdown of the Company s French subsidiaries, which had been reflected as a discontinued operation. These tax benefits ($7.4 million) were recognized as earnings from discontinued operations in the third quarter of 2009 due to the realization that such tax benefits became more likely than not upon the conclusion of an IRS audit of the Company s 2006 federal income tax return.

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Results of Operations Nine Months Ended September 30, 2010

The Company s net sales for the nine months ended September 30, 2010 increased $17.9 million, or 9.2%, to $211.8 million from $193.9 million in the same period in 2009. The net increase was due to increases in both water and specialty application products as well as the addition of the Cox Flow Measurement product line as discussed above.

Water application products represented 85.5% of sales for the nine months ended September 30, 2010 compared to 89.9% for the same period in 2009. These sales increased $6.8 million, or 3.9%, to $181.1 million compared to $174.3 million in the same period in 2009. The increase was the net effect of lower volumes of manual read meters, slightly higher volumes of meters sold with AMR/AMI technology, lower volumes of commercial meters and higher prices. Sales of the Company s ORION AMR technology products increased 7.4% in the first nine months of 2010 from the same period in 2009, while sales of the Itron related products increased 2.0%. In this nine month period of 2010, ORION related products outsold Itron related products by a ratio of 2.4 to 1. Commercial sales increased 1.5% in the first nine months of 2010 over the same period in 2009. The slowdown experienced in 2009 due to weak economic conditions and delayed purchasing decisions caused by uncertainties over the availability of funds under U.S. government stimulus programs continued into early 2010. The Company believes stimulus fund spending decisions made in mid-February 2010 eased uncertainties in the marketplace and caused delayed purchases to resume, resulting in the overall increase in year-to-date sales.

Specialty products represented 14.5% of sales for the nine month period ended September 30, 2010 compared to 10.1% for the same period in 2009. These sales increased nearly $11.1 million, or 56.6%, to $30.7 million for the first nine months of 2010 from $19.6 million for the first nine months of 2009. The increases were driven by higher sales volumes in most of the specialty application product lines during the first nine months of 2010 over the same period in 2009, which were low due to weak economic conditions, increased sales of radio technology to natural gas utilities for connection to their gas meters and the addition of the Cox Flow Measurement product line.

The gross margin as a percentage of net sales was 36.9% for the first nine months of 2010 compared to 39.5% in the same period in 2009. The decline was due to increased costs of meter castings which fluctuate with the metals market, particularly copper, and higher costs associated with meeting certain Made in America requirements for stimulus fund related purchases. These were offset somewhat by higher prices charged for certain of the Company s products, product mix, favorable currency exchange rates on foreign-sourced electronic components and more efficient plant utilization.

Selling, engineering and administration expenses increased $1.3 million, or 3.2%, in the nine month period ended September 30, 2010 compared to the same period in 2009. Higher expenses associated with the Cox Flow Measurement acquisition and increased employee incentive programs were partially offset by a one-time credit of $0.7 million for the fair value of land received in the same industrial park where the Company s Mexican facilities are located. The land was received in settlement of claims against a building construction contractor. In addition, the 2009 amounts included charges associated with early retirement programs offered to certain employees that did not reoccur in 2010. Expenses are also affected by normal inflationary increases, offset by continuing cost controls.

Interest expense for the nine months ended September 30, 2010 was $0.3 million compared to interest income of $0.3 million for the same period in 2009, which included a reversal of $1.2 million of interest expense related to favorable resolution of previously unrecognized tax benefits. Interest expense on the Company s debt continued to decline as cash generated from operations was used to lower the average debt balances.

The provision for income taxes as a percentage of earnings from continuing operations before income taxes for the nine month period ended September 30, 2010 was 35.8% compared to 38.1% in the same period in 2009. The primary reason for the decrease was a revised estimate of overall lower state income taxes for 2010 as well as the adjustments necessary to estimated deductions upon filing the Company s tax returns.

As a result of the above mentioned items, earnings from continuing operations for the nine months ended September 30, 2010 were $22.4 million compared to $21.7 million in the nine month period ended September 30, 2009. On a diluted basis, earnings per share from continuing operations were $1.49 for the first nine months of 2010 compared to $1.45 for the same period in 2009.

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Liquidity and Capital Resources

The main sources of liquidity for the Company are cash from operations and borrowing capacity. Cash provided by operations for the first nine months of 2010 was $13.7 million compared to $24.6 million for the first nine months of 2009. The decline was the net impact of increases in accounts receivable and inventory balances, offset somewhat by lower pension payments and the timing of tax payments.

The receivables balance increased from $35.8 million at December 31, 2009 to $53.4 million at September 30, 2010 due to higher sales in the most recent period. The Company continues to believe that the current economic conditions will not significantly impact collections of the Company s outstanding receivables.

Inventories at September 30, 2010 increased to $41.3 million from $32.5 million at December 31, 2009. Historically, balances are lower at year-end than at other times of the year due to seasonality factors. Longer lead times from suppliers and the timing of purchases also contributed to the increase. The recent acquisition of Cox Flow Measurement represented $1.1 million of the inventory increase.

Net property, plant and equipment at September 30, 2010 increased by $2.5 million compared to the balance at December 31, 2009 as the result of $7.0 million of capital expenditures, offset by depreciation expense. Included in the net increase was $0.7 million related to land obtained from the settlement of a legal suit and $0.3 million related to the acquisition of Cox Flow Measurement.

The increase in intangible assets from $23.6 million at December 31, 2009 to $34.7 million at September 30, 2010 was due primarily to a payment of $8.0 million to license the manufacture and sale of a key component of the Company s line of turbine meters. Also included in the increase were the intangible assets acquired as part of the Cox Flow Measurement acquisition discussed above. The increase was offset somewhat by amortization expense.

Other long-term assets increased to $7.4 million at September 30, 2010 from $5.8 million at December 31, 2009 due primarily to the Company investing $1.5 million to purchase a small ownership percentage in an emerging technology company. Goodwill increased to $9.0 million at September 30, 2010 from $7.0 million at December 31, 2009 due to the Cox Flow Measurement acquisition. The Company performs its annual impairment test for intangibles and goodwill in the fourth quarter. The Company did not identify any indicators of impairment to date in 2010 that would require interim valuations.

Short-term debt at September 30, 2010 increased to $13.1 million compared to the balance at December 31, 2009 of $2.6 million as the Company purchased the license agreement for the turbine technology discussed above, contributed $4.7 million to its domestic pension plan and purchased Cox Flow Measurement for $7.8 million. During the same period, current maturities of long-term debt decreased from $5.4 million to zero at September 30, 2010 due to regularly scheduled payments. The Company s debt is unsecured and does not carry any financial covenants.

Payables increased to $14.2 million at September 30, 2010 from $10.8 million at December 31, 2009 primarily due to the timing of payments and to inventory purchases. Accrued compensation and employee benefits at September 30, 2010 increased to $7.4 million from $6.1 million at December 31, 2009 due to the current year accruals for employee incentive compensation, offset somewhat by the payment of employee incentive compensation amounts earned at December 31, 2009.

Accrued income and other taxes increased to $7.5 million at September 30, 2010 from $0.5 million at December 31, 2009 due to the current year accruals for taxes and to the timing of tax payments.

Other accrued employee benefits decreased to $7.1 million at September 30, 2010 from $12.0 million at December 31, 2009 due to the net effect of current year accruals and payments, including the $4.7 million pension plan contribution discussed above.

Common stock and capital in excess of par value both increased slightly since December 31, 2009 due to new stock issued in connection with the exercise of stock options. Employee benefit stock increased as a result of the Company making a $1.5 million loan to the Badger Meter Employee Savings and Stock Ownership Plan (ESSOP) in the third quarter of 2010 in exchange for the ESSOP agreeing to extend the program through December 31, 2020. The ESSOP was previously set to expire on December 31, 2011. For additional information, refer to note 7 D of the Company s Annual Report on Form 10-K for the year ended December 31, 2009 and Note 4 to the Unaudited Consolidated Condensed Financial Statements in this filing.

The Company believes its financial condition remains strong. In October 2010, the Company renewed its principal line of credit (increasing it from $35.0 million to $50.0 million) for one year. The Company believes that its operating cash flows, available borrowing capacity, and its ability to raise capital provide adequate resources to fund ongoing operating requirements, future capital expenditures and the development of new products. The Company had $32.5 million of unused credit lines available at September 30, 2010.

Other Matters

There are currently no material legal proceedings pending with respect to the Company. The more significant legal proceedings are discussed below.

The Company is subject to contingencies related to environmental laws and regulations. The Company is named as one of many potentially responsible parties in two landfill lawsuits and is in the process of resolving a claim related to a parcel of land adjoining the Company s property. The landfill sites are impacted by the Federal Comprehensive Environmental Response, Compensation and Liability Act and other environmental laws and regulations. At this time, the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the Company s financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. Regarding the landfill sites, this belief is based on the Company s assessment of its limited past involvement with these landfill sites as well as the substantial involvement of and government focus on other named third parties with these landfill sites. However, due to the inherent uncertainties of such proceedings, the Company cannot predict the ultimate outcome of any of these matters. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2009 and the first three quarters of 2010 were not material.

Like other companies in recent years, the Company has been named as a defendant in numerous multi-claimant/multi-defendant lawsuits alleging personal injury as a result of exposure to asbestos, manufactured by third parties, and integrated into or sold with a very limited number of the Company s products. The Company is vigorously defending itself against these claims. Although it is not possible to predict the ultimate outcome of these matters, the Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company s financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. This belief is based in part on the fact that no claimant has proven or substantially demonstrated asbestos exposure caused by products manufactured or sold by the Company and that a number of cases have been voluntarily dismissed.

See the Special Note Regarding Forward Looking Statements at the front of this Quarterly Report on Form 10-Q and Part I, Item 1A Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2009 for a discussion of risks and uncertainties that could impact the Company s financial performance and results of operations.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company s off-balance sheet arrangements and contractual obligations are discussed in Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations under the headings Off-Balance Sheet Arrangements and Contractual Obligations in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, and have not materially changed since that report was filed except for the changes to the ESSOP as discussed in Note 4 and short-term debt as discussed in Note 8 to the Unaudited Consolidated Condensed Financial Statements in this filing.

Item 3 Quantitative and Qualitative Disclosures about Market Risk

The Company s quantitative and qualitative disclosures about market risk are included in Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations under the heading Market Risks in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, and have not materially changed since that report was filed.

Item 4 Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act), the Company s management evaluated, with the participation of the Company s Chairman, President and Chief Executive Officer and the Company s Senior Vice President Finance, Chief Financial Officer and Treasurer, the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the quarter ended September 30, 2010. Based upon their evaluation of these disclosure controls and procedures, the Company s Chairman, President and Chief Executive Officer and the Company s Senior Vice President Finance, Chief Financial Officer and Treasurer concluded that the Company s disclosure controls and procedures were effective as of the end of the quarter ended September 30, 2010.

Changes in Internal Control over Financial Reporting

There was no change in the Company s internal control over financial reporting that occurred during the quarter ended September 30, 2010, that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Part II Other Information

Item 6 Exhibits

Exhibit No.	Description
4.1	Loan Agreement dated October 30, 2010 between Badger Meter, Inc. and the M&I Marshall & Ilsley Bank relating to Badger Meter s revolving credit loan.
4.2	Loan Agreement dated October 30, 2010 between Badger Meter, Inc. and the M&I Marshall & Ilsley Bank relating to Badger Meter s euro note.
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Periodic Financial Report by the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	BADGER METER, INC.
Dated: October 26, 2010	By /s/ Richard A. Meeusen Richard A. Meeusen Chairman, President and Chief Executive Officer
	By /s/ Richard E. Johnson Richard E. Johnson Senior Vice President Finance, Chief Financial Officer and Treasurer
	By /s/ Beverly L. P. Smiley Beverly L. P. Smiley Vice President Controller

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Exhibit Index

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