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

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016

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

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

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

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

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

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

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

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ITRON, INC.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

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

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

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

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

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

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

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

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ITRON, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2016
(UNAUDITED)
In this Quarterly Report on Form 10-Q, the terms “we,” “us,” “our,” “Itron,” and the “Company” refer to Itron, Inc.

Note 1: Summary of Significant Accounting Policies

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

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

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

Prepaid Debt Fees
Prepaid debt fees for term debt represent the capitalized direct costs incurred related to the issuance of debt and are recorded as a direct deduction from the carrying amount of the corresponding debt liability. We have elected to present prepaid debt fees for revolving debt within other long-term assets in the Consolidated Balance Sheets. These costs are amortized to interest expense over the terms of the respective borrowings, including contingent maturity or call features, using the effective interest method, or straight-line method when associated with a revolving credit facility. When debt is repaid early, the related portion of unamortized prepaid debt fees is written off and included in interest expense.

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

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

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

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

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

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

New Accounting Pronouncements

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

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

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

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

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

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

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

Note 2: Earnings Per Share

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

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

Stock-based Awards

For stock-based awards, the dilutive effect is calculated using the treasury stock method. Under this method, the dilutive effect is computed as if the awards were exercised at the beginning of the period (or at time of issuance, if later) and assumes the related proceeds were used to repurchase common stock at the average market price during the period. Related proceeds include the amount the employee must pay upon exercise, future compensation cost associated with the stock award, and the amount of excess tax benefits, if any. Approximately 0.9 million and 0.8 million stock-based awards were excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2016 because they were anti-dilutive. Approximately 1.1 million and 1.2 million stock-based awards were excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2015 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

Note 3: Certain Balance Sheet Components

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

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

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

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

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

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

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

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

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Note 4: Intangible Assets

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

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

A summary of intangible asset activity is as follows:

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

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

Estimated future annual amortization expense is as follows:

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

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Note 5: Goodwill

The following table reflects goodwill allocated to each reporting unit:

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

Note 6: Debt

The components of our borrowings were as follows:

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

Credit Facility

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

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

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

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

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

Credit facility repayments were as follows:

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

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

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

	September 30, 2016	December 31, 2015
	(in thousands)	
Unamortized prepaid debt fees - revolver	$2,596	$ 3,128
Unamortized prepaid debt fees - term loan	837	1,047

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Note 7: Derivative Financial Instruments

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

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

The fair values of our derivative instruments were as follows:

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

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

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

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

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

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

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

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

Cash Flow Hedges

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

In May 2012, we entered into six interest rate swaps, which were effective July 31, 2013 and expired on August 8, 2016, to convert $200 million of our LIBOR based debt from a floating LIBOR interest rate to a fixed interest rate of 1.00% (excluding the applicable margin on the debt). The cash flow hedges were expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk through the term of the hedge. Consequently, effective changes in the fair value of the interest rate swaps were recorded as a component of other comprehensive income (loss) (OCI) and recognized in earnings when the hedged item affected earnings. The amounts paid on the hedges were recognized as adjustments to interest expense.

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

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

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

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

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

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

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

Derivatives Not Designated as Hedging Relationships

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

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

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

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

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Note 8: Defined Benefit Pension Plans

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

Amounts recognized on the Consolidated Balance Sheets consist of:

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

Our asset investment strategy focuses on maintaining a portfolio using primarily insurance funds, which are accounted for as investments and measured at fair value, in order to achieve our long-term investment objectives on a risk adjusted basis. Our general funding policy for these qualified pension plans is to contribute amounts sufficient to satisfy regulatory funding standards of the respective countries for each plan.

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

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

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Note 9: Stock-Based Compensation

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

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

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

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

Stock Options

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Dividend yield[1]	— %	-%	— %	— %
Expected volatility[1]	33.7 %	-%	33.5%	34.5%
Risk-free interest rate[1]	1.3 %	-%	1.3 %	1.7 %

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

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

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

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A summary of our stock option activity is as follows:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value[1]	Weighted Average Grant Date Fair Value
	(in thousands)		(years)	(in thousands)	
Outstanding, January 1, 2015	1,123	$ 51.90	4.4	$ 1,676	
Granted	207	35.30			$ 12.15
Exercised	(23)	36.05		26	
Forfeited	(17)	37.47			
Expired	(167)	53.95			
Outstanding, September 30, 2015	1,123	$ 49.12	5.4	$ —	
Outstanding, January 1, 2016	1,180	$ 48.31	5.7	$ 405	
Granted	191	40.40			$ 13.27
Exercised	(35)	35.31		214	
Forfeited	(36)	35.29			
Expired	(312)	55.11			
Outstanding, September 30, 2016	988	$ 45.57	6.8	$ 13,732	
Exercisable September 30, 2016	563	$ 51.57	5.1	$ 6,024	
Expected to vest, September 30, 2016	410	$ 37.58	8.9	$ 7,448	

(1) The aggregate intrinsic value of outstanding stock options represents amounts that would have been received by the optionees had all in- the-money options been exercised on that date. Specifically, it is the amount by which the market value of our stock exceeded the exercise price of the outstanding in-the-money options before applicable income taxes, based on our closing stock price on the last business day of the period. The aggregate intrinsic value of stock options exercised during the period is calculated based on our stock price at the date of exercise.

At September 30, 2016, total unrecognized stock-based compensation expense related to nonvested stock options was approximately $3.8 million, which is expected to be recognized over a weighted average period of approximately 2.0 years.

Restricted Stock Units

Certain employees, senior management, and members of the Board of Directors receive restricted stock units as a component of their total compensation. The fair value of a restricted stock unit is the market close price of our common stock on the date of grant. Restricted stock units generally vest over a three year period. Compensation expense, net of forfeitures, is recognized over the vesting period.

Subsequent to vesting, the restricted stock units are converted into shares of our common stock on a one-for-one basis and issued to employees. We are entitled to an income tax deduction in an amount equal to the taxable income reported by the employees upon vesting of the restricted stock units.

Beginning in 2013, the performance-based restricted stock units to be issued under the Long-Term Performance Restricted Stock Unit Award Agreement (Performance Award Agreement) were determined based on (1) our achievement of specified non-GAAP EPS targets, as established by the Board at the beginning of each year for each of the three 1-year calendar years contained in the performance period (the performance condition) and (2) our total

shareholder return (TSR) relative to the TSR attained by companies that are included in the Russell 3000 Index during the 3-year performance period (the market condition). Compensation expense, net of forfeitures, is recognized on a straight-line basis, and the restricted stock units vest upon achievement of the performance condition, provided participants are employed by Itron at the end of the respective performance periods. For U.S. participants who retire during the performance period, a pro-rated number of restricted stock units (based on the number of days of employment during the performance period) immediately vest based on the attainment of the performance goals as assessed after the end of the performance period.

Depending on the level of achievement of the performance condition, the actual number of shares to be earned ranges between 0% and 160% of the awards originally granted. At the end of the performance periods, if the performance conditions are achieved at or above threshold, the number of shares earned is further adjusted by a TSR multiplier payout percentage, which ranges between 75% and 125%, based on the market condition. Therefore, based on the attainment of the performance and market conditions, the actual number of shares that vest may range from 0% to 200% of the awards originally granted. Due to the presence of the TSR

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multiplier market condition, we utilize a Monte Carlo valuation model to determine the fair value of the awards at the grant date. This pricing model uses multiple simulations to evaluate the probability of our achievement of various stock price levels to determine our expected TSR performance ranking. The weighted-average assumptions used to estimate the fair value of performance-based restricted stock units granted and the resulting weighted average fair value are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Dividend yield[1]	—%	—%	—%	—%
Expected volatility[1]	28.8%	—%	30.0%	30.1%
Risk-free interest rate[1]	0.8%	—%	0.7%	0.7%
Expected term (years)[1]	2.3	—	1.8	2.1
Weighted average fair value[1]	$63.10	$ —	$44.92	$33.48

(1) There were no long-term performance restricted stock units granted for the three months ended September 30, 2015.

Expected volatility is based on the historical volatility of our common stock for the related expected term. We believe this approach is reflective of current and historical market conditions and is an appropriate indicator of expected volatility. The risk-free interest rate is the rate available as of the award date on zero-coupon U.S. government issues with a term equal to the expected term of the award. The expected term is the term of an award based on the period of time between the date of the award and the date the award is expected to vest. The expected term assumption is based upon the plan's performance period as of the date of the award. We have not paid dividends in the past and do not plan to pay dividends in the foreseeable future.

The following table summarizes restricted stock unit activity:

	Number of Restricted Stock Units	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value[1]
	(in thousands)		(in thousands)
Outstanding, January 1, 2015	682		
Granted[2]	319	$ 35.30	
Released	(288)		$ 11,852
Forfeited	(54)		
Outstanding, September 30, 2015	659		
Outstanding, January 1, 2016	756		
Granted[2]	196	$ 41.58	
Released	(280)		$ 10,823
Forfeited	(50)		
Outstanding, September 30, 2016	622		
Vested but not released, September 30, 2016	5		$ 277
Expected to vest, September 30, 2016	500		$ 27,894

(1) The aggregate intrinsic value is the market value of the stock, before applicable income taxes, based on the closing price on the stock release dates or at the end of the period for restricted stock units expected to vest.

(2) Restricted stock units granted in 2015 and 2016 do not include awards under the Performance Award Agreement for the respective years, as these awards are not granted until attainment of annual performance goals has been determined at the conclusion of the performance period, which had not occurred as of September 30, 2015 and 2016, respectively.

At September 30, 2016, total unrecognized compensation expense on restricted stock units was $25.3 million, which is expected to be recognized over a weighted average period of approximately 2.0 years.

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Phantom Stock Units

Phantom stock units are a form of share-based award that are indexed to our stock price and are settled in cash upon vesting. Since phantom stock units are settled in cash, compensation expense recognized over the vesting period will vary based on changes in fair value. Fair value is remeasured at the end of each reporting period based on the market close price of our common stock.

The following table summarizes phantom stock unit activity:

	Number of Phantom Stock Units (in thousands)	Weighted Average Grant Date Fair Value
Outstanding, January 1, 2016	—	
Granted	63	$ 40.11
Forfeited	(1)	
Outstanding, September 30, 2016	62	
Expected to vest, September 30, 2016	56	

At September 30, 2016, total unrecognized compensation expense on phantom stock units was $2.8 million, which is expected to be recognized over a weighted average period of approximately 2.4 years. We have recorded a phantom stock liability of $0.7 million within wages and benefits payable in the Consolidated Balance Sheets as of September 30, 2016.

Unrestricted Stock Awards

We grant unrestricted stock awards to members of our Board of Directors as part of their compensation. Awards are fully vested and expensed when granted. The fair value of unrestricted stock awards is the market close price of our common stock on the date of grant.

The following table summarizes unrestricted stock award activity:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands, except per share data)			
Shares of unrestricted stock granted	4	6	17	14
Weighted average grant date fair value per share	$53.96	$33.91	$42.24	$36.51

Employee Stock Purchase Plan

Under the terms of the ESPP, employees can deduct up to 10% of their regular cash compensation to purchase our common stock at a 5% discount from the fair market value of the stock at the end of each fiscal quarter, subject to other limitations under the plan. The sale of the stock to the employees occurs at the beginning of the subsequent quarter. The ESPP is not considered compensatory, and no compensation expense is recognized for sales of our common stock to employees.

The following table summarizes ESPP activity:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Shares of stock sold to employees[1]	—	11	20	39

(1) Stock sold to employees during each fiscal quarter under the ESPP is associated with the offering period ending on the last day of the previous fiscal quarter. No stock was sold under the ESPP during the third quarter of 2016 because the ESPP had been suspended due to our delayed SEC filings. We became current with our SEC filings on September 2, 2016 and the ESPP is again active.

There were approximately 371,000 shares of common stock available for future issuance under the ESPP at September 30, 2016.

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Note 10: Income Taxes

Our tax provision as a percentage of income before tax typically differs from the federal statutory rate of 35%, and may vary from period to period, due to fluctuations in the forecast mix of earnings in domestic and international jurisdictions, new or revised tax legislation and accounting pronouncements, tax credits, state income taxes, adjustments to valuation allowances, and uncertain tax positions, among other items.

Our tax expense for the three and nine months ended September 30, 2016 differed from the federal statutory rate of 35% due to the forecasted mix of earnings in domestic and international jurisdictions and losses experienced in jurisdictions with valuation allowances on deferred tax assets.

Our tax expense for the three and nine months ended September 30, 2015 differed from the federal statutory rate of 35% due to the forecasted mix of earnings in domestic and international jurisdictions, losses experienced in jurisdictions with valuation allowances, and discrete tax items.

We classify interest expense and penalties related to unrecognized tax liabilities and interest income on tax overpayments as components of income tax expense. The net interest and penalties expense recognized were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Net interest and penalties expense	$591	$170	$923	$645

Accrued interest and penalties recorded were as follows:

	September 30, 2016	December 31, 2015
	(in thousands)	
Accrued interest	$2,733	$ 2,105
Accrued penalties	3,070	2,577

Unrecognized tax benefits related to uncertain tax positions and the amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate were as follows:

	September 30, 2016	December 31, 2015
	(in thousands)	
Unrecognized tax benefits related to uncertain tax positions	$56,216	$ 54,880
The amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate	54,908	53,602

At September 30, 2016, we are under examination by certain tax authorities for the 2000 to 2014 tax years. The material jurisdictions where we are subject to examination for the 2000 to 2014 tax years include, among others, the United States, France, Germany, Italy, Brazil and the United Kingdom. No material changes have occurred to previously disclosed assessments. We believe we have appropriately accrued for the expected outcome of all tax

matters and do not currently anticipate that the ultimate resolution of these examinations will have a material adverse effect on our financial condition, future results of operations, or liquidity.

Based upon the timing and outcome of examinations, litigation, the impact of legislative, regulatory, and judicial developments, and the impact of these items on the statute of limitations, it is reasonably possible that the related unrecognized tax benefits could change from those recorded within the next twelve months. However, at this time, an estimate of the range of reasonably possible adjustments to the balance of unrecognized tax benefits cannot be made.

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Note 11: Commitments and Contingencies

Guarantees and Indemnifications

We are often required to obtain standby letters of credit (LOCs) or bonds in support of our obligations for customer contracts. These standby LOCs or bonds typically provide a guarantee to the customer for future performance, which usually covers the installation phase of a contract and may, on occasion, cover the operations and maintenance phase of outsourcing contracts.

Our available lines of credit, outstanding standby LOCs, and performance bonds were as follows:

	September 30, 2016	December 31, 2015
	(in thousands)	
Credit facilities[1]		
Multicurrency revolving line of credit	$500,000	$ 500,000
Long-term borrowings	(132,597)	(151,837)
Standby LOCs issued and outstanding	(46,071)	(46,574)
Net available for additional borrowings under the multi-currency revolving line of credit	$321,332	$ 301,589
Net available for additional standby LOCs under sub-facility[2]	203,929	253,426
Unsecured multicurrency revolving lines of credit with various financial institutions		
Multicurrency revolving lines of credit	$98,655	$ 97,989
Standby LOCs issued and outstanding	(23,818)	(31,122)
Short-term borrowings[3]	(2,205)	(3,884)
Net available for additional borrowings and LOCs	$72,632	$ 62,983
Unsecured surety bonds in force	$85,883	$ 87,558

(1) Refer to Note 6 for details regarding our secured credit facilities.

(2) During the nine months ended September 30, 2016, as a result of entering into the first and second amendments to the 2015 credit facility, the maximum limit available for additional standby LOCs under sub-facility was reduced from $300 million to $250 million.

(3) Short-term borrowings are included in “Other current liabilities” on the Consolidated Balance Sheets.

In the event any such standby LOC or bond is called, we would be obligated to reimburse the issuer of the standby LOC or bond; however, we do not believe that any outstanding LOC or bond will be called.

We generally provide an indemnification related to the infringement of any patent, copyright, trademark, or other intellectual property right on software or equipment within our sales contracts, which indemnifies the customer from and pays the resulting costs, damages, and attorney’s fees awarded against a customer with respect to such a claim provided that: 1) the customer promptly notifies us in writing of the claim and 2) we have the sole control of the defense and all related settlement negotiations. We may also provide an indemnification to our customers for third party claims resulting from damages caused by the negligence or willful misconduct of our employees/agents in connection with the performance of certain contracts. The terms of our indemnifications generally do not limit the maximum potential payments. It is not possible to predict the maximum potential amount of future payments under these or similar agreements.

Legal Matters

We are subject to various legal proceedings and claims of which the outcomes are subject to significant uncertainty. Our policy is to assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the liability required, if any, for these contingencies is made after an analysis of each known issue. A liability is recorded and charged to operating expense when we determine that a loss is probable and the amount can be reasonably estimated. Additionally, we disclose contingencies for which a material loss is reasonably possible, but not probable.

On July 14, 2016, we entered into a confidential settlement agreement with Transdata Incorporated (Transdata) under which Transdata agreed to dismiss with prejudice all pending litigation in various United States District Courts against us and certain of our customers. As a part of the settlement, we received a patent license from Transdata for the use of the patents in future meter production and sales.

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In Brazil, the Conselho Administravo de Defesa Economica commenced an investigation of water meter suppliers, including our subsidiary, to determine whether such suppliers participated in agreements or concerted practices to coordinate their commercial policy in Brazil. On October 18, 2016, we settled with the Conselho Administravo de Defesa Economica. The settlement was not material to our results of operations or financial condition.

Itron and its subsidiaries are parties to various employment-related proceedings in jurisdictions where it does business. None of the proceedings are individually material to Itron, and we believe that we have made adequate provision such that the ultimate disposition of the proceedings will not materially affect Itron's business or financial condition.

Warranty

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Beginning balance	$45,457	$58,139	$54,512	$36,548
New product warranties	1,976	1,760	5,881	4,767
Other changes/adjustments to warranties	1,662	2,492	3,697	29,589
Claims activity	(4,485)	(7,396)	(19,488)	(14,062)
Effect of change in exchange rates	176	(251)	184	(2,098)
Ending balance	44,786	54,744	44,786	54,744
Less: current portion of warranty	26,084	40,060	26,084	40,060
Long-term warranty	$18,702	$14,684	$18,702	$14,684

Total warranty expense is classified within cost of revenues and consists of new product warranties issued, costs related to extended warranty contracts, and other changes and adjustments to warranties. Warranty expense was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Total warranty expense	$3,638	$4,252	$9,578	$34,356

Unearned Revenue Related to Extended Warranty

A summary of changes to unearned revenue for extended warranty contracts is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Beginning balance	$33,068	$34,084	$33,654	$34,138
Unearned revenue for new extended warranties	352	826	1,366	2,251
Unearned revenue recognized	(905)	(716)	(2,640)	(2,029)
Effect of change in exchange rates	(31)	(187)	104	(353)

Ending balance	32,484	34,007	32,484	34,007
Less: current portion of unearned revenue for extended warranty	4,134	3,416	4,134	3,416
Long-term unearned revenue for extended warranty within other long-term obligations	$28,350	$30,591	$28,350	$30,591

Health Benefits

We are self insured for a substantial portion of the cost of our U.S. employee group health insurance. We purchase insurance from a third party, which provides individual and aggregate stop-loss protection for these costs. Each reporting period, we expense the costs of our health insurance plan including paid claims, the change in the estimate of incurred but not reported (IBNR) claims, taxes, and administrative fees (collectively, the plan costs).

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Plan costs were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Plan costs	$6,727	$5,803	$20,360	$18,704

The IBNR accrual, which is included in wages and benefits payable, was as follows:

	September 30, 2016	December 31, 2015
	(in thousands)	
IBNR accrual	$2,346	$ 2,051

Our IBNR accrual and expenses may fluctuate due to the number of plan participants, claims activity, and deductible limits. For our employees located outside of the United States, health benefits are provided primarily through governmental social plans, which are funded through employee and employer tax withholdings.

Note 12: Restructuring

2016 Projects

On September 1, 2016, we announced projects (2016 Projects) to restructure various company activities in order to improve operational efficiencies, reduce expenses and improve competiveness. We expect to close or consolidate several facilities and reduce our global workforce as a result of the restructuring.

The 2016 Projects began during the three months ended September 30, 2016, and we expect to substantially complete the 2016 Projects by the end of 2018. Many of the affected employees are represented by unions or works councils, which requires consultation, and potential restructuring projects may be subject to regulatory approval, both of which could impact the timing of charges, total expected charges, cost recognized, and planned savings in certain jurisdictions.

The total expected restructuring costs, the restructuring costs recognized during the nine months ended September 30, 2016, and the remaining expected restructuring costs as of September 30, 2016 related to the 2016 Projects are as follows:

	Total Expected Costs at September 30, 2016	Costs Recognized During the Nine Months Ended September 30, 2016	Expected Remaining Costs to be Recognized at September 30, 2016
	(in thousands)		
Employee severance costs	$44,162	$ 34,662	$ 9,500
Asset impairments & net loss on sale or disposal	5,184	5,184	—
Other restructuring costs	16,652	152	16,500
Total	$65,998	$ 39,998	$ 26,000

Segments:			
Electricity	$10,044	$ 6,544	$ 3,500
Gas	33,214	20,214	13,000
Water	21,410	12,410	9,000
Corporate unallocated	1,330	830	500
Total	$65,998	$ 39,998	$ 26,000

2014 Projects

In November 2014, our management approved restructuring projects (2014 Projects) to restructure our Electricity business and related general and administrative activities, along with certain Gas and Water activities, to improve operational efficiencies and reduce expenses. The 2014 Projects include consolidation of certain facilities and reduction of our global workforce. The improved structure positions us to meet our long-term profitability goals by better aligning global operations with markets where we can serve our customers profitably.

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We began implementing these projects in the fourth quarter of 2014, and substantially completed them in the third quarter of 2016. Project activities will continue through the fourth quarter of 2017, however, no further costs are expected to be recognized related to the 2014 Projects.

The total expected restructuring costs, the restructuring costs recognized in prior periods, the restructuring costs recognized during the nine months ended September 30, 2016, and the remaining expected restructuring costs as of September 30, 2016 related to the 2014 Projects were as follows:

	Total Expected Costs at September 30, 2016	Costs Recognized in Prior Periods	Costs Recognized During the Nine Months Ended September 30, 2016	Expected Remaining Costs to be Recognized at September 30, 2016
	(in thousands)			
Employee severance costs	$34,630	$ 34,373	$ 257	$ —
Asset impairments & net loss on sale or disposal	8,849	8,880	(31)	—
Other restructuring costs	4,999	3,929	1,070	—
Total	$48,478	$ 47,182	$ 1,296	$ —
Segments:				
Electricity	$20,610	$ 21,743	$ (1,133)	$ —
Gas	13,631	11,855	1,776	—
Water	1,995	1,940	55	—
Corporate unallocated	12,242	11,644	598	—
Total	$48,478	$ 47,182	$ 1,296	$ —

2013 Projects

In September 2013, our management approved projects (the 2013 Projects) to restructure our operations to improve profitability and increase efficiencies. We began implementing these projects in the third quarter of 2013, and completed the projects during the third quarter of 2016.

The 2013 Projects resulted in approximately $26.2 million of restructuring expense, which was recognized from the third quarter of 2013 through the fourth quarter of 2014.

The following table summarizes the activity within the restructuring related balance sheet accounts for the 2016, 2014 and 2013 Projects during the nine months ended September 30, 2016:

	Accrued Employee Severance	Asset Impairments & Net Loss on Sale or Disposal	Other Accrued Costs	Total
	(in thousands)			
Beginning balance, January 1, 2016	$26,533	$ —	$3,048	$29,581
Costs charged to expense	34,919	5,153	1,222	41,294
Cash payments	(14,476)	—	(1,331)	(15,807)
Non-cash items	—	(5,153)	—	(5,153)

Effect of change in exchange rates	(95)	—	(5)	(100)
Ending balance, September 30, 2016	$46,881	$ —	$2,934	$49,815

Asset impairments are determined at the asset group level. Revenues and net operating income from the activities we have exited or will exit under the restructuring projects are not material to our operating segments or consolidated results.

Other restructuring costs include expenses for employee relocation, professional fees associated with employee severance, and costs to exit the facilities once the operations in those facilities have ceased. Costs associated with restructuring activities are generally presented in the Consolidated Statements of Operations as restructuring, except for certain costs associated with inventory write-downs, which are classified within cost of revenues, and accelerated depreciation expense, which is recognized according to the use of the asset.

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The current restructuring liabilities were $20.3 million and $25.2 million as of September 30, 2016 and December 31, 2015. The current restructuring liabilities are classified within other current liabilities on the Consolidated Balance Sheets. The long-term restructuring liabilities balances were $29.5 million and $4.4 million as of September 30, 2016 and December 31, 2015. The long-term restructuring liabilities are classified within other long-term obligations on the Consolidated Balance Sheets, and include facility exit costs and severance accruals.

Note 13: Shareholders' Equity

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 would 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. There was no preferred stock issued or outstanding at September 30, 2016 and December 31, 2015.

Other Comprehensive Income (Loss)

The before-tax amount, income tax (provision) benefit, and net-of-tax amount related to each component of OCI were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Before-tax amount				
Foreign currency translation adjustment	$9,128	$(15,528)	$12,856	$(62,461)
Foreign currency translation adjustment reclassified into net income on disposal	—	962	(1,407)	962
Net unrealized gain (loss) on derivative instruments designated as cash flow hedges	602	(296)	(6,039)	(1,104)
Net hedging loss reclassified into net income	279	412	845	1,235
Pension benefit obligation adjustment	(1,725)	877	(2,520)	1,887
Total other comprehensive income (loss), before tax	8,284	(13,573)	3,735	(59,481)
Tax (provision) benefit				
Foreign currency translation adjustment	56	325	(539)	696
Foreign currency translation adjustment reclassified into net income on disposal	—	—	—	—
Net unrealized gain (loss) on derivative instruments designated as cash flow hedges	(231)	114	2,330	423
Net hedging loss reclassified into net income	(108)	(159)	(326)	(474)
Pension benefit obligation adjustment	527	(11)	713	(24)
Total other comprehensive income (loss) tax benefit	244	269	2,178	621
Net-of-tax amount				
Foreign currency translation adjustment	9,184	(15,203)	12,317	(61,765)
Foreign currency translation adjustment reclassified into net income on disposal	—	962	(1,407)	962
	371	(182)	(3,709)	(681)

Net unrealized gain (loss) on derivative instruments designated as cash flow hedges				
Net hedging loss reclassified into net income	171	253	519	761
Pension benefit obligation adjustment	(1,198)	866	(1,807)	1,863
Total other comprehensive income (loss), net of tax	$8,528	$(13,304)	$5,913	$(58,860)

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The changes in the components of AOCI, net of tax, were as follows:

	Foreign Currency Translation Adjustments	Net Unrealized Gain (Loss) on Derivative Instruments	Net Unrealized Gain (Loss) on Nonderivative Instruments	Pension Benefit Obligation Adjustments	Total
	(in thousands)				
Balances at January 1, 2015	$(85,080)	$ (768)	$ (14,380)	$ (34,832)	$(135,060)
OCI before reclassifications	(61,765)	(681)	—	(1)	(62,447)
Amounts reclassified from AOCI	962	761	—	1,864	3,587
Total other comprehensive income (loss)	(60,803)	80	—	1,863	(58,860)
Balances at September 30, 2015	$(145,883)	$ (688)	$ (14,380)	$ (32,969)	$(193,920)
Balances at January 1, 2016	$(158,009)	$ 318	$ (14,380)	$ (28,536)	$(200,607)
OCI before reclassifications	12,317	(3,709)	—	(713)	7,895
Amounts reclassified from AOCI	(1,407)	519	—	(1,094)	(1,982)
Total other comprehensive income (loss)	10,910	(3,190)	—	(1,807)	5,913
Balances at September 30, 2016	$(147,099)	$ (2,872)	$ (14,380)	$ (30,343)	$(194,694)

Details about the AOCI components reclassified to the Consolidated Statements of Operations are as follows:

	Amount Reclassified from AOCI[1]				Affected Line Item in the Consolidated Statements of Operations
	Three Months Ended September 30,		Nine Months Ended September 30,		
	2016	2015	2016	2015	
	(in thousands)				
Amortization of defined benefit pension items					
Prior-service costs	$16	$(14)	$47	$(43)	[2]
Actuarial losses	330	(488)	991	(1,470)	[2]
Settlement and Other	498	(375)	488	(375)	[2]
Total, before tax	844	(877)	1,526	(1,888)	Income before income taxes
Tax benefit (provision)	(272)	11	(432)	24	Income tax provision
Total reclassified, net of tax	$572	$(866)	$1,094	$(1,864)	Net income

[1] Amounts in parentheses indicate debits to the Consolidated Statements of Operations.

[2] These AOCI components are included in the computation of net periodic pension cost. Refer to Note 8 for additional details.

Refer to Note 7 for additional details related to derivative activities that resulted in reclassification of AOCI to the Consolidated Statements of Operations.

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Note 14: Fair Values of Financial Instruments

The fair values at September 30, 2016 and December 31, 2015 do not reflect subsequent changes in the economy, interest rates, and other variables that may affect the determination of fair value. The following table presents the fair values of our financial instruments:

	September 30, 2016		December 31, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)			
Assets				
Cash and cash equivalents	$151,380	$151,380	$131,018	$131,018
Foreign exchange forwards	119	119	27	27
Interest rate swaps	—	—	1,632	1,632
Interest rate caps	300	300	1,423	1,423
Liabilities				
Credit facility				
USD denominated term loan	$210,938	$209,317	$219,375	$217,830
Multicurrency revolving line of credit	132,597	131,387	151,837	150,570
Interest rate swaps	3,308	3,308	868	868
Foreign exchange forwards	294	294	99	99

The following methods and assumptions were used in estimating fair values:

Cash and cash equivalents: Due to the liquid nature of these instruments, the carrying amount approximates fair value (Level 1).

Credit facility - term loan and multicurrency revolving line of credit: The term loan and revolver are not traded publicly. The fair values, which are valued based upon a hypothetical market participant, are calculated using a discounted cash flow model with Level 2 inputs, including estimates of incremental borrowing rates for debt with similar terms, maturities, and credit profiles. Refer to Note 6 for a further discussion of our debt.

Derivatives: See Note 7 for a description of our methods and assumptions in determining the fair value of our derivatives, which were determined using Level 2 inputs.

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Note 15: Segment Information

We operate under the Itron brand worldwide and manage and report under three operating segments: Electricity, Gas, and Water. Our Water operating segment includes both our global water and heat solutions. This structure allows each segment to develop its own go-to-market strategy, prioritize its marketing and product development requirements, and focus on its strategic investments. Our sales, marketing, and delivery functions are managed under each segment. Our product development and manufacturing operations are managed on a worldwide basis to promote a global perspective in our operations and processes and yet still maintain alignment with the segments.

We have three GAAP measures of segment performance: revenue, gross profit (margin), and operating income (margin). Our operating segments have distinct products, and, therefore, intersegment revenues are minimal. Certain operating expenses are allocated to the operating segments based upon internally established allocation methodologies. Corporate operating expenses, interest income, interest expense, other income (expense), and income tax provision are not allocated to the segments, nor included in the measure of segment profit or loss. In addition, we allocate only certain production assets and intangible assets to our operating segments. We do not manage the performance of the segments on a balance sheet basis.

Segment Products

Electricity	Standard electricity (electromechanical and electronic) meters; advanced electricity meters and communication modules; smart electricity meters; smart electricity communication modules; prepayment systems, including smart key, keypad, and smart card communication technologies; advanced systems including handheld, mobile, and fixed network collection technologies; smart network technologies; meter data management software; knowledge application solutions; installation; implementation; and professional services including consulting and analysis.
Gas	Standard gas meters; advanced gas meters and communication modules; smart gas meters; smart gas communication modules; prepayment systems, including smart key, keypad, and smart card communication technologies; advanced systems, including handheld, mobile, and fixed network collection technologies; smart network technologies; meter data management software; knowledge application solutions; installation; implementation; and professional services including consulting and analysis.
Water	Standard water and heat meters; advanced and smart water meters and communication modules; smart heat meters; advanced systems including handheld, mobile, and fixed network collection technologies; meter data management software; knowledge application solutions; installation; implementation; and professional services including consulting and analysis.

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Revenues, gross profit, and operating income associated with our segments were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Revenues				
Electricity	$242,667	$206,810	$692,785	$602,999
Gas	144,185	136,726	433,707	401,099
Water	120,007	125,992	390,981	382,987
Total Company	$506,859	$469,528	$1,517,473	$1,387,085
Gross profit				
Electricity	$75,362	$56,385	$210,840	$163,330
Gas	56,096	46,790	158,156	134,854
Water	39,291	44,115	134,661	106,082
Total Company	$170,749	$147,290	$503,657	$404,266
Operating income (loss)				
Electricity	$20,452	$9,819	$51,092	$14,958
Gas	7,136	15,836	48,811	44,986
Water	(3,546)	14,265	28,707	11,415
Corporate unallocated	(17,632)	(12,980)	(63,153)	(34,891)
Total Company	6,410	26,940	65,457	36,468
Total other income (expense)	(1,882)	(3,738)	(8,824)	(11,899)
Income before income taxes	$4,528	$23,202	$56,633	$24,569

For the three and nine months ended September 30, 2016, one customer represented 14% and 12%, respectively, of total Electricity segment revenues. For the three months ended September 30, 2015, one customer represented 11% of total Electricity segment revenues, while no customer represented more than 10% of total Electricity segment revenues for the nine months ended September 30, 2015. For the three and nine months ended September 30, 2016 and September 30, 2015, no single customer represented more than 10% of the Gas or Water operating segment revenues, or total company revenues.

Revenues by region were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
United States and Canada	$297,116	$256,962	$837,468	$737,112
Europe, Middle East, and Africa	161,959	167,577	545,517	514,054
Other[1]	47,784	44,989	134,488	135,919
Total revenues	$506,859	$469,528	$1,517,473	$1,387,085

[1] The Other region includes our operations in Latin America and Asia Pacific.

Depreciation and amortization expense associated with our segments was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Electricity	$6,682	$8,878	$21,715	$27,427
Gas	5,595	4,743	15,484	15,316
Water	5,022	5,280	14,040	14,806
Corporate unallocated	(1,217)	97	324	241
Total Company	$16,082	$18,998	$51,563	$57,790

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

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes included in this report and with our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission (SEC) on June 30, 2016.

Documents we provide to the SEC are available free of charge under the Investors section of our website at www.itron.com as soon as practicable after they are filed with or furnished to the SEC. In addition, these documents are available at the SEC's website (http://www.sec.gov), at the SEC's Headquarters at 100 F Street, NE, Washington, DC 20549, or by calling 1-800-SEC-0330.

Certain Forward-Looking Statements

This document contains forward-looking statements concerning our operations, financial performance, revenues, earnings growth, liquidity, restructuring, and other items. This document reflects our current plans and expectations and is based on information currently available as of the date of this Quarterly Report on Form 10-Q. When we use the words "expect," "intend," "anticipate," "believe," "plan," "project," "estimate," "future," "objective," "may," "will," "will c similar expressions, they are intended to identify forward-looking statements. Forward-looking statements rely on a number of assumptions and estimates. Although we believe that these assumptions and estimates are reasonable, any of these assumptions and estimates could prove to be inaccurate and the forward looking statements based on them could be incorrect and cause our actual results to vary materially from expected results. Our operations involve risks and uncertainties which could materially affect our results of operations and whether the forward looking statements ultimately prove to be correct. These risks and uncertainties include 1) the rate and timing of customer demand for our products, 2) failure to meet performance or delivery milestones in customer contracts, 3) changes in estimated liabilities for product warranties and/or litigation, 4) changes in foreign currency exchange rates and interest rates, 5) rescheduling or cancellations of current customer orders and commitments, 6) our dependence on customers' acceptance of new products and their performance, 7) competition, 8) changes in domestic and international laws and regulations, 9) international business risks, 10) our own and our customers' or suppliers' access to and cost of capital, 11) future business combinations, and 12) other factors. For a more complete description of these and other risks, refer to Item 1A: "Risk Factors" included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, which was filed with the SEC on June 30, 2016 and our other reports on file with the SEC. We do not undertake any obligation to update or revise any forward looking statement in this document.

Overview

We are a technology company, offering end-to-end metering solutions to electric, natural gas, and water utilities around the world. Our smart metering solutions, meter data management software, and knowledge application solutions bring additional value to a utility's metering and grid systems. Our professional services help our customers project-manage, install, implement, operate, and maintain their systems. We operate under the Itron brand worldwide and manage and report under three operating segments, Electricity, Gas, and Water. Our Water operating segment includes both our global water and heat solutions. This structure allows each segment to develop its own go-to-market strategy, prioritize its marketing and product development requirements, and focus on its strategic investments. Our sales, marketing, and delivery functions are managed under each segment. Our product development and manufacturing operations are managed on a worldwide basis to promote a global perspective in our operations and processes and yet still maintain alignment with the segments.

We have three measures of segment performance: revenue, gross profit (margin), and operating income (margin). Intersegment revenues are minimal. Certain operating expenses are allocated to the operating segments based upon internally established allocation methodologies. Interest income, interest expense, other income (expense), income tax

provision, and certain corporate operating expenses are neither allocated to the segments nor included in the measures of segment performance.

The following discussion includes financial information prepared in accordance with accounting principles generally accepted in the United States (GAAP), as well as certain adjusted or non-GAAP financial measures such as constant currency, free cash flow, non-GAAP operating expense, non-GAAP operating income, non-GAAP net income, adjusted EBITDA, and non-GAAP diluted earnings per share (EPS). We believe that non-GAAP financial measures, when reviewed in conjunction with GAAP financial measures, can provide more information to assist investors in evaluating current period performance and in assessing future performance. For these reasons, our internal management reporting also includes non-GAAP measures. We strongly encourage investors and shareholders to review our financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure. Non-GAAP measures as presented herein may not be comparable to similarly titled measures used by other companies.

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In our discussions of the operating results below, we sometimes refer to the impact of foreign currency exchange rate fluctuations, which are references to the differences between the foreign currency exchange rates we use to convert operating results from local currencies into U.S. dollars for reporting purposes. We also use the term “constant currency,” which represents results adjusted to exclude foreign currency exchange rate impacts. We calculate the constant currency change as the difference between the current period results translated using the current period currency exchange rates and the comparable prior period’s results restated using current period currency exchange rates. We believe the reconciliations of changes in constant currency provide useful supplementary information to investors in light of fluctuations in foreign currency exchange rates.

Refer to the Non-GAAP Measures section below on pages 45-47 for the detailed reconciliation of items that impacted free cash flow, non-GAAP operating expense, non-GAAP operating income, non-GAAP net income, adjusted EBITDA, and non-GAAP diluted EPS in the presented periods.

Total Company Highlights and Unit Shipments

Highlights and significant developments for the three months ended September 30, 2016

- Revenues were $506.9 million compared with $469.5 million in the same period last year, an increase of $37.3 million, or 8%.
- Gross margin was 33.7% compared with 31.4% in the same period last year. The gross margin improvement of 230 basis points included improvements in our Electricity and Gas segments.
- Operating expenses were $44.0 million higher compared with the same period last year primarily due to increased restructuring expense following our announcement of the 2016 restructuring projects (2016 Projects).
- Net loss attributable to Itron, Inc. for the third quarter of 2016 was $9.9 million compared with net income attributable to Itron, Inc. of $12.6 million in the same period last year.
- Adjusted EBITDA improved to $62.7 million, an increase of $21.2 million compared with the same period last year.
- GAAP diluted EPS declined $0.59 to $(0.26) compared with the same period last year, primarily due to the increased restructuring charges.
- Non-GAAP diluted EPS improved $0.33 to $0.77 compared with the same period last year.

Highlights and significant developments for the nine months ended September 30, 2016

- Revenues were $1.5 billion compared with $1.4 billion in the same period last year, an increase of $130.4 million, or 9%.
- Gross margin was 33.2% compared with 29.1% in the same period last year. The gross margin improvement of 410 basis points included improvements in all segments.
- Operating expenses were $70.4 million higher compared with the same period last year, primarily due to increased restructuring expenses following the announcement of the 2016 Projects.
- Net income attributable to Itron, Inc. was $20.1 million compared with $3.7 million for the same period in 2015.

- Adjusted EBITDA increased $79.7 million, or 106% compared with the same period in 2015.

- GAAP diluted EPS was $0.52, a $0.42 improvement compared with the same period in 2015.

- Non-GAAP diluted EPS improved $1.59 to $1.87 compared with the same period last year.

- Total backlog was $1.5 billion and twelve-month backlog was $731 million at September 30, 2016.

On September 1, 2016, we announced the 2016 Projects to restructure various company activities in order to improve operational efficiencies, reduce expenses and improve competiveness. We expect to close or consolidate several facilities and reduce our global workforce as a result of the restructuring. As a result of the announcement, we recognized $40.0 million of restructuring expense during the third quarter of 2016 related to the 2016 Projects.

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We expect to substantially complete the 2016 Projects by the end of 2018. Many of the affected employees are represented by unions or works councils, which requires consultation, and potential restructuring projects may be subject to regulatory approval, both of which could impact the timing of charges, total expected charges, costs recognized, and planned savings in certain jurisdictions.

We estimate pre-tax restructuring charges of approximately $66 million, with expected annualized savings of approximately $40 million upon completion.

The following table summarizes the changes in GAAP and Non-GAAP financial measures:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
	(in thousands, except margin and per share data)					
GAAP						
Revenues	$506,859	$469,528	8%	$1,517,473	$1,387,085	9%
Gross profit	170,749	147,290	16%	503,657	404,266	25%
Operating expenses	164,339	120,350	37%	438,200	367,798	19%
Operating income	6,410	26,940	(76)%	65,457	36,468	79%
Other income (expense)	(1,882)	(3,738)	(50)%	(8,824)	(11,899)	(26)%
Income tax provision	(13,430)	(9,932)	35%	(34,249)	(19,060)	80%
Net income (loss) attributable to Itron, Inc.	(9,885)	12,640	N/A	20,121	3,692	445%
Non-GAAP[(1)]						
Non-GAAP operating expenses	$118,844	$115,165	3%	$378,106	$358,450	5%
Non-GAAP operating income	51,905	32,125	62%	125,551	45,816	174%
Non-GAAP net income attributable to Itron, Inc.	29,896	16,974	76%	71,871	10,615	577%
Adjusted EBITDA	62,715	41,505	51%	154,775	75,056	106%
GAAP Margins and Earnings Per Share						
Gross margin	33.7%	31.4%		33.2%	29.1%	
Operating margin	1.3%	5.7%		4.3%	2.6%	
Basic EPS	$(0.26)	$0.33		$0.53	$0.10	
Diluted EPS	(0.26)	0.33		0.52	0.10	
Non-GAAP Earnings Per Share[(1)]						
Non-GAAP diluted EPS	$0.77	$0.44		$1.87	$0.28	

(1) These measures exclude certain expenses that we do not believe are indicative of our core operating results. See pages 45-47 for information about these non-GAAP measures and reconciliations to the most comparable GAAP measures.

Meter and Module Summary

We classify meters into three categories:

- Standard metering – no built-in remote reading communication technology
- Advanced metering – one-way communication of meter data
- Smart metering – two-way communication including remote meter configuration and upgrade (consisting primarily of our OpenWay® technology)

In addition, advanced and smart meter communication modules can be sold separately from the meter.

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Our revenue is driven significantly by sales of meters and communication modules. A summary of our meter and communication module shipments is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(units in thousands)			
Meters				
Standard	3,520	4,100	12,020	13,540
Advanced and Smart	2,390	1,930	6,900	5,330
Total meters	5,910	6,030	18,920	18,870
Stand-alone communication modules				
Advanced and Smart	1,570	1,530	4,470	4,250

Results of Operations

Revenue and Gross Margin

The actual results and effects of changes in foreign currency exchange rates in revenues and gross profit were as follows:

	Three Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Total Company					
Revenues	$506,859	$469,528	$(5,195)	$42,526	$37,331
Gross profit	170,749	147,290	(2,103)	25,562	23,459

	Nine Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Total Company					
Revenues	$1,517,473	$1,387,085	$(27,691)	$158,079	$130,388
Gross profit	503,657	404,266	(7,009)	106,400	99,391

(1) Constant currency change is a non-GAAP financial measure and represents the total change between periods excluding the effect of changes in foreign currency exchange rates.

Revenues

Revenues increased $37.3 million and $130.4 million, or 8% and 9%, for the three and nine months ended September 30, 2016, compared with the same periods in 2015. Revenues in the Electricity and Gas segments increased by $35.9 million and $7.5 million, respectively, for the three months ended September 30, 2016. Revenues in the Water segment declined $6.0 million during the third quarter of 2016 as compared to the same period in 2015. Revenues in the Electricity, Gas, and Water segments increased by $89.8 million, $32.6 million, and $8.0 million, respectively, for the nine months ended September 30, 2016. The total change in revenues for the three and nine months ended September 30, 2016 were unfavorably impacted by $5.2 million and $27.7 million, respectively, due to the effect of changes in foreign currency exchange rates.

Our 10 largest customers accounted for 33% and 31% of total revenues during the three and nine months ended September 30, 2016, and 24% and 23% of total revenues during the three and nine months ended September 30, 2015. For further discussion of customer concentrations for the segments and total company, refer to Item 1: “Financial Statements, Note 15: Segment Information.”

Gross Margin

Gross margin for the third quarter of 2016 was 33.7%, compared with 31.4% for the same period in 2015. The improvement in gross margin was primarily driven by improved revenues and product mix across our Electricity and Gas segments. Gross margin

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for the nine months ended September 30, 2016 was 33.2%, compared with 29.1% for the same period in 2015. The improvement was primarily driven by a significant warranty charge in our Water segment in 2015 that negatively impacted gross margin, as well as improved revenues and product mix in our Electricity and Gas segments.

Operating Expenses

The actual results and effects of changes in foreign currency exchange rates in operating expenses were as follows:

	Three Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Total Company					
Sales and marketing	$38,894	$39,217	$(330)	$7	$(323)
Product development	39,386	41,559	(249)	(1,924)	(2,173)
General and administrative	40,384	31,118	(310)	9,576	9,266
Amortization of intangible assets	4,996	7,869	(152)	(2,721)	(2,873)
Restructuring	40,679	587	(128)	40,220	40,092
Total Operating expenses	$164,339	$120,350	$(1,169)	$45,158	$43,989

	Nine Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Total Company					
Sales and marketing	$119,037	$123,302	$(2,325)	$(1,940)	$(4,265)
Product development	128,086	126,399	(793)	2,480	1,687
General and administrative	130,781	103,195	(2,053)	29,639	27,586
Amortization of intangible assets	19,002	23,730	(490)	(4,238)	(4,728)
Restructuring	41,294	(8,828)	(307)	50,429	50,122
Total Operating expenses	$438,200	$367,798	$(5,968)	$76,370	$70,402

(1) Constant currency change is a non-GAAP financial measure and represents the total change between periods excluding the effect of changes in foreign currency exchange rates.

Operating expenses increased $44.0 million for the three months ended September 30, 2016 as compared with the same period in 2015. The increase was primarily related to an increase in restructuring expense of $40.1 million, and an increase in general and administrative expense of $9.3 million related to increased professional services costs in 2016 and a $3.4 million litigation recovery that reduced general and administrative expenses during the third quarter of 2015.

Operating expenses increased $70.4 million for the nine months ended September 30, 2016 as compared with the same period in 2015. The increase was primarily related to an increase in restructuring expense of $50.1 million, and

an increase in general and administrative expense of $27.6 million due to increased legal costs and professional services in 2016, and an $8.0 million litigation recovery that reduced these expenses in 2015.

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Other Income (Expense)

The following table shows the components of other income (expense):

	Three Months Ended September 30,		% Change	Nine Months Ended September 30,		% Change
	2016	2015		2016	2015	
	(in thousands)			(in thousands)		
Interest income	$102	$180	(43)%	$594	$440	35%
Interest expense	(2,419)	(2,526)	(4)%	(7,538)	(7,485)	1%
Amortization of prepaid debt fees	(272)	(273)	—%	(806)	(1,851)	(56)%
Other income (expense), net	707	(1,119)	N/A	(1,074)	(3,003)	(64)%
Total other income (expense)	$(1,882)	$(3,738)	(50)%	$(8,824)	$(11,899)	(26)%

Total other income (expense) for the three months ended September 30, 2016 was a net expense of $1.9 million compared with $3.7 million in the same period in 2015. Total other income (expense) for the nine months ended September 30, 2016 was a net expense of $8.8 million compared with $11.9 million in the same period in 2015. The other income (expense), net, change for the three and nine months ended September 30, 2016 as compared with the same period in 2015 was due to fluctuations in the recognized foreign currency exchange gains and losses due to balances denominated in a currency other than the reporting entity's functional currency.

Income Tax Provision

For the three and nine months ended September 30, 2016, the income tax provisions were $13.4 million and $34.2 million compared with $9.9 million and $19.1 million for the same periods in 2015. Our tax rates for the three and nine months ended September 30, 2016 of 297% and 60% differed from the federal statutory rate of 35% due to the forecasted mix of earnings in domestic and international jurisdictions and losses, in particular related to restructuring charges recognized during the third quarter, experienced in jurisdictions with valuation allowances on deferred tax assets. Our tax rates for the three and nine months ended September 30, 2015 of 43% and 78% differed from the federal statutory rate of 35% due to the forecasted mix of earnings in domestic and international jurisdictions, valuation allowances, and discrete tax items.

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Operating Segment Results

For a description of our operating segments, refer to Item 1: “Financial Statements Note 15: Segment Information.”

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
Segment Revenues	(in thousands)			(in thousands)		
Electricity	$242,667	$206,810	17%	$692,785	$602,999	15%
Gas	144,185	136,726	5%	433,707	401,099	8%
Water	120,007	125,992	(5)%	390,981	382,987	2%
Total revenues	$506,859	$469,528	8%	$1,517,473	$1,387,085	9%

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016		2015		2016		2015	
	Gross Profit	Gross Margin	Gross Profit	Gross Margin	Gross Profit	Gross Margin	Gross Profit	Gross Margin
Segment Gross Profit and Margin	(in thousands)		(in thousands)		(in thousands)		(in thousands)	
Electricity	$75,362	31.1%	$56,385	27.3%	$210,840	30.4%	$163,330	27.1%
Gas	56,096	38.9%	46,790	34.2%	158,156	36.5%	134,854	33.6%
Water	39,291	32.7%	44,115	35.0%	134,661	34.4%	106,082	27.7%
Total gross profit and margin	$170,749	33.7%	$147,290	31.4%	$503,657	33.2%	$404,266	29.1%

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
Segment Operating Expenses	(in thousands)			(in thousands)		
Electricity	$54,910	$46,566	18%	$159,748	$148,372	8%
Gas	48,960	30,954	58%	109,345	89,868	22%
Water	42,837	29,850	44%	105,954	94,667	12%
Corporate unallocated	17,632	12,980	36%	63,153	34,891	81%
Total operating expenses	$164,339	$120,350	37%	$438,200	$367,798	19%

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016		2015		2016		2015	
	Operating Income (Loss)	Operating Margin	Operating Income (Loss)	Operating Margin	Operating Income (Loss)	Operating Margin	Operating Income (Loss)	Operating Margin
Segment Operating Income (Loss) and Operating Margin	(in thousands)		(in thousands)		(in thousands)		(in thousands)	
Electricity	$20,452	8.4%	$9,819	4.7%	$51,092	7.4%	$14,958	2.5%
Gas	7,136	4.9%	15,836	11.6%	48,811	11.3%	44,986	11.2%
Water	(3,546)	(3.0)%	14,265	11.3%	28,707	7.3%	11,415	3.0%
Corporate unallocated	(17,632)		(12,980)		(63,153)		(34,891)	
Total Company	$6,410	1.3%	$26,940	5.7%	$65,457	4.3%	$36,468	2.6%

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Electricity

The effects of changes in foreign currency exchange rates and the constant currency changes in certain Electricity segment financial results were as follows:

	Three Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Electricity Segment					
Revenues	$242,667	$206,810	$(2,767)	$38,624	$35,857
Gross profit	75,362	56,385	(1,555)	20,532	18,977
Operating expenses	54,910	46,566	(755)	9,099	8,344

	Nine Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Electricity Segment					
Revenues	$692,785	$602,999	$(14,333)	$104,119	$89,786
Gross profit	210,840	163,330	(3,880)	51,390	47,510
Operating expenses	159,748	148,372	(2,864)	14,240	11,376

(1) Constant currency change is a non-GAAP financial measure and represents the total change between periods excluding the effect of changes in foreign currency exchange rates.

Revenues - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Revenues increased $35.9 million, or 17%, for the three months ended September 30, 2016, compared with the same period in 2015. This increase was primarily driven by increased product revenues from advanced and smart meter sales in North America and Europe, Middle East, and Africa (EMEA). These improvements were partially offset by declines in EMEA service revenues. The total change in Electricity revenues was unfavorably impacted by $2.8 million due to the effect of changes in foreign currency exchange rates.

Revenues - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Revenues increased $89.8 million, or 15%, for the nine months ended September 30, 2016, compared with the same period in 2015. Revenues were higher in 2016 primarily due to increased product revenues and professional services in North America. Increased EMEA product revenues also contributed to the growth while EMEA service revenues declined during the period. The total change in Electricity revenues was unfavorably impacted by $14.3 million due to the effect of changes in foreign currency exchange rates.

Gross Margin - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Gross margin was 31.1% for the three months ended September 30, 2016, compared with 27.3% for the same period in 2015. The 380 basis point increase over the prior year was primarily the result of an improved product mix and

volumes.

Gross Margin - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
For the nine months ended September 30, 2016, gross margin was 30.4%, compared with 27.1% for the same period in 2015. The 330 basis point improvement over the prior year was primarily the result of increased revenue from higher margin smart meters.

Operating Expenses - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Operating expenses increased $8.3 million, or 18%, for the three months ended September 30, 2016, compared with the same period in 2015. The increase was caused by a $5.4 million increase in general and administrative expense, primarily due to a $3.4 million reimbursement received in 2015 related to the settlement of litigation arising from the SmartSynch acquisition. In addition, the recognition of the 2016 Projects in the third quarter of 2016 resulted in an increase in restructuring expense as compared to 2015. These increases were partially offset by decreases in amortization of intangible assets, product development, and sales and marketing expenses.

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Operating Expenses - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Operating expenses increased $11.4 million, or 8%, for the nine months ended September 30, 2016, compared with the same period in 2015. The increase resulted primarily from receiving a reimbursement of $8.0 million in 2015 related to the settlement of litigation arising from the SmartSynch acquisition. In addition, restructuring expense increased in 2016 following the recognition of the 2016 Projects. These increases were partially offset by decreases in sales and marketing, product development, and amortization of intangible assets expenses.

Gas

The effects of changes in foreign currency exchange rates and the constant currency changes in certain Gas segment financial results were as follows:

	Three Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Gas Segment					
Revenues	$144,185	$136,726	$ (1,420)	$ 8,879	$7,459
Gross profit	56,096	46,790	(275)	9,581	9,306
Operating expenses	48,960	30,954	(293)	18,299	18,006

	Nine Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Gas Segment					
Revenues	$433,707	$401,099	$ (5,112)	$ 37,720	$32,608
Gross profit	158,156	134,854	(780)	24,082	23,302
Operating expenses	109,345	89,868	(954)	20,431	19,477

(1) Constant currency change is a non-GAAP financial measure and represents the total change between periods excluding the effect of changes in foreign currency exchange rates.

Revenues - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Revenues increased $7.5 million, or 5%, for the three months ended September 30, 2016 compared with the same period in 2015. This was primarily due to an increase in product sales in North America.

Revenues - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Revenues increased $32.6 million, or 8%, for the nine months ended September 30, 2016, compared with the same period in 2015. This was due an increase in product sales in North America, EMEA, and Asia Pacific. The total change in Gas revenues was unfavorably impacted by $5.1 million due to the effect of changes in foreign currency exchange rates.

Gross Margin - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Gross margin was 38.9% for the three months ended September 30, 2016, compared with 34.2% for the same period in 2015. The 470 basis point increase was related to increased sales of higher margin products in North America and improved margins in EMEA.

Gross Margin - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Gross margin was 36.5% for the nine months ended September 30, 2016, compared with 33.6% for the same period in 2015. The increase of 290 basis points was related to improved product mix and increased volumes.

Operating Expenses - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Operating expenses increased $18.0 million, or 58%, for the three months ended September 30, 2016, compared with the same period in 2015. The increase was primarily due to higher restructuring expense following the recognition of the 2016 Projects, partially offset by a decrease in general and administrative expense.

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Operating Expenses - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Operating expenses increased $19.5 million, or 22%, for the nine months ended September 30, 2016, compared with the same period in 2015. The increase was primarily due to higher restructuring expenses following the recognition of the 2016 Projects, partially offset by a decrease in general and administrative expense.

Water

The effects of changes in foreign currency exchange rates and the constant currency changes in certain Water segment financial results were as follows:

	Three Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Water Segment					
Revenues	$120,007	$125,992	$ (1,008)	$ (4,977)	$ (5,985)
Gross profit	39,291	44,115	(273)	(4,551)	(4,824)
Operating expenses	42,837	29,850	85	12,902	12,987

	Nine Months Ended September 30,		Effect of Changes in Foreign Currency Exchange Rates	Constant Currency Change[1]	Total Change
	2016	2015			
	(in thousands)				
Water Segment					
Revenues	$390,981	$382,987	$ (8,247)	$ 16,241	$7,994
Gross profit	134,661	106,082	(2,349)	30,928	28,579
Operating expenses	105,954	94,667	(882)	12,169	11,287

(1) Constant currency change is a non-GAAP financial measure and represents the total change between periods excluding the effect of changes in foreign currency exchange rates.

Revenues - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Revenues decreased $6.0 million, or 5%, for the three months ended September 30, 2016, compared with the third quarter of 2015. This was primarily due to lower meter volumes in EMEA and Asia Pacific.

Revenues - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Revenues increased $8.0 million, or 2%, for the nine months ended September 30, 2016, compared with the same period last year. This increase was primarily due to increased product revenues in North America and EMEA. This was partially offset by lower revenues in Latin America. The total change in Water revenues was unfavorably impacted by $8.2 million due to the effect of changes in foreign currency exchange rates.

Gross Margin - Three months ended September 30, 2016 vs. Three months ended September 30, 2015

During the third quarter of 2016 gross margin decreased to 32.7%, compared with 35.0% in 2015. The decrease in gross margin was driven by unfavorable product mix in EMEA and Latin America, as well as lower volumes in EMEA.

Gross Margin - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Gross margin increased to 34.4% for the nine months ended September 30, 2016, compared with 27.7% for the same period last year, driven by reduced warranty charges in 2016. The nine months ended September 30, 2015 included a $28.2 million warranty accrual associated with our preliminary failure estimates for certain communication modules manufactured between July 2013 and December 2014. This additional warranty expense reduced gross margin by 7.4 percentage points during the nine months ended September 30, 2015.

Operating Expenses - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Operating expenses for the three months ended September 30, 2016 increased by $13.0 million, or 44%, compared with the third quarter of 2015. The increase was primarily due to restructuring expense associated with the 2016 Projects that was recognized during the third quarter of 2016.

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Operating Expenses - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Operating expenses for the nine months ended September 30, 2016 increased by $11.3 million, or 12%, compared with the same period last year. The increase was primarily due to restructuring expense associated with the 2016 Projects recognized during the third quarter of 2016, partially offset by a decrease in general and administrative expense.

Corporate unallocated

Corporate Unallocated Expenses - Three months ended September 30, 2016 vs. Three months ended September 30, 2015
Operating expenses not directly associated with an operating segment are classified as “Corporate unallocated.” These expenses increased by $4.7 million, or 36%, for the three months ended September 30, 2016 compared with the same period in 2015. The increase was primarily due to increased professional service fees associated with the revision of previously issued financial statements, as discussed in our 2015 Annual Report on Form 10-K, along with increased legal costs.

Corporate Unallocated Expenses - Nine months ended September 30, 2016 vs. Nine months ended September 30, 2015
Corporate unallocated expenses increased by $28.3 million or 81%, for the nine months ended September 30, 2016 compared with the same period in 2015. The increase was primarily due to increased professional service fees associated with the revision of previously issued financial statements, as discussed in our 2015 Annual Report on Form 10-K, along with increased legal costs.

Bookings and Backlog of Orders

Bookings for a reported period represent customer contracts and purchase orders received during the period that have met certain conditions, such as regulatory and/or contractual approval. Total backlog represents committed but undelivered products and services for contracts and purchase orders at period end. Twelve-month backlog represents the portion of total backlog that we estimate will be recognized as revenue over the next 12 months. Backlog is not a complete measure of our future revenues as we also receive significant book-and-ship orders. Bookings and backlog may fluctuate significantly due to the timing of large project awards. In addition, annual or multi-year contracts are subject to rescheduling and cancellation by customers due to the long-term nature of the contracts. Beginning total backlog, plus bookings, minus revenues, will not equal ending total backlog due to miscellaneous contract adjustments, fluctuations in foreign currency exchange rates, and other factors.

Quarter Ended	Quarterly Bookings	Ending Total Backlog[1]	Ending 12-Month Backlog
	(in millions)		
September 30, 2016	$670	$ 1,511	$ 731
June 30, 2016	349	1,345	688
March 31, 2016	394	1,504	785
December 31, 2015	822	1,575	836
September 30, 2015	337	1,252	734

(1) The March 31, 2016 ending total backlog was adjusted for an error as the prior periods’ backlog did not reflect the deferral of 2011 and 2012 revenues as disclosed in our 2015 Annual Report on Form 10-K (2015 Form 10-K). This revenue deferral was properly recorded as a beginning retained earnings balance adjustment for the year ended

December 31, 2013 in the 2015 Form 10-K. The total backlog was adjusted upward by approximately $29 million, which is not considered material.

Information on bookings by our operating segments is as follows:

Quarter Ended	Total Bookings	Electricity	Gas	Water
	(in millions)			
September 30, 2016	$670	$ 372	$176	$122
June 30, 2016	349	109	114	126
March 31, 2016	394	145	137	112
December 31, 2015	822	441	251	130
September 30, 2015	337	151	100	86

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Financial Condition

Cash Flow Information:

	Nine Months Ended September 30,	
	2016	2015
	(in thousands)	
Operating activities	$81,881	$20,154
Investing activities	(32,772)	(38,533)
Financing activities	(30,696)	28,355
Effect of exchange rates on cash and cash equivalents	1,949	(12,889)
Increase in cash and cash equivalents	$20,362	$(2,913)

Cash and cash equivalents was $151.4 million at September 30, 2016, compared with $131.0 million at December 31, 2015.

Operating activities
Cash provided by operating activities during the nine months ended September 30, 2016 was $81.9 million compared with $20.2 million during the same period in 2015. The increase in cash provided was primarily due to an improvement in net income adjusted for non-cash items and changes in operating asset and liabilities. These adjustments include a $76.7 million decreased use of cash for inventory caused by a prior year buildup for expected demand in North America and EMEA. In addition, $40.0 million of restructuring expense was recognized related to the 2016 Projects, much of which will be paid in future periods. These improvements were offset by the $28.2 million warranty charge recorded during the nine months ended September 30, 2015 related to a product replacement notification to customers of our Water business line, for which many replacements have been processed during 2016.

Investing activities
Cash used by investing activities during the nine months ended September 30, 2016 was $5.8 million lower compared with the same period in 2015.

Financing activities
Net cash used by financing activities during the nine months ended September 30, 2016 was $30.7 million, compared with a cash source of $28.4 million for the same period in 2015. The increased use of cash by financing activities is primarily a result of repaying $29.0 million of borrowings in the nine months ended September 30, 2016, compared to utilizing $59.5 million of net proceeds and payments during the same period in 2015, as free cash flow was sufficient to fund operating and investing activities and pay down existing debt. This was partially offset by a $35.3 million reduction in cash used for repurchases of common stock during the nine months ended September 30, 2016, compared with the same period in 2015.

Effect of exchange rates on cash and cash equivalents
The effect of exchange rates on the cash balances of currencies held in foreign denominations for the nine months ended September 30, 2016 was an increase of $1.9 million, compared with a decrease of $12.9 million for the same period in 2015. The impact of exchange rates is the result of an increase in U.S. dollar value compared with most foreign currencies during the nine months ended September 30, 2015.

Free cash flow (Non-GAAP)

To supplement our Consolidated Statements of Cash Flows presented on a GAAP basis, we use the non-GAAP measure of free cash flow to analyze cash flows generated from our operations. The presentation of non-GAAP free cash flow is not meant to be considered in isolation or as an alternative to net income as an indicator of our performance, or as an alternative to cash flows provided by (used in) operating activities as a measure of liquidity. We calculate free cash flows, using amounts from our Consolidated Statements of Cash Flows, as follows:

	Nine Months Ended September 30,	
	2016	2015
	(in thousands)	
Net cash provided by operating activities	$81,881	$20,154
Acquisitions of property, plant, and equipment	(30,563)	(33,324)
Free cash flow	$51,318	$(13,170)

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Free cash flow increased primarily as a result of higher cash provided by operating activities. See the cash flow discussion of operating activities above.

Off-balance sheet arrangements:

We have no off-balance sheet financing agreements or guarantees as defined by Item 303 of Regulation S-K at September 30, 2016 and December 31, 2015 that we believe are reasonably likely to have a current or future effect on our financial condition, results of operations, or cash flows.

Liquidity and Capital Resources:

Our principal sources of liquidity are cash flows from operations, borrowings, and sales of common stock. Cash flows may fluctuate and are sensitive to many factors including changes in working capital and the timing and magnitude of capital expenditures and payments of debt. Working capital, which represents current assets less current liabilities, was $352.5 million at September 30, 2016, compared with $281.2 million at December 31, 2015.

Borrowings
Our credit facility consists of a $225 million U.S. dollar term loan and a multicurrency revolving line of credit (the revolver) with a principal amount of up to $500 million. The revolver also contains a $250 million letter of credit sub-facility and a $50 million swingline sub-facility (available for immediate cash needs at a higher interest rate). At September 30, 2016, $132.6 million was outstanding under the revolver, and $321.3 million was available for additional borrowings or standby letters of credit. At September 30, 2016, $46.1 million was utilized by outstanding standby letters of credit, resulting in $203.9 million available for additional letters of credit.

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

For further description of the term loan and the revolver under our 2015 credit facility, refer to Item 1: “Financial Statements, Note 6: Debt.”

For a description of our letters of credit and performance bonds, and the amounts available for additional borrowings or letters of credit under our lines of credit, including the revolver that is part of our credit facility, refer to Item 1: “Financial Statements, Note 11: Commitments and Contingencies.”

Restructuring
On September 1, 2016, we announced projects (2016 Projects) to restructure various company activities in order to improve operational efficiencies, reduce expenses and improve competiveness. We expect to close or consolidate several facilities and reduce our global workforce as a result of the restructuring.

We expect to substantially complete the 2016 Projects by the end of 2018. Many of the affected employees are represented by unions or works councils, which requires consultation, and potential restructuring projects may be subject to regulatory approval, both of which could impact the timing of charges, total expected charges, costs recognized, and planned savings in certain jurisdictions.

We expect pre-tax restructuring charges associated with the 2016 Projects of approximately $66 million, with expected annualized savings of approximately $40 million upon completion. Of the total estimated charge, more than 90% is expected to result in cash expenditures.

As of September 30, 2016, $49.8 million was accrued for the restructuring projects, of which $20.3 million is expected to be paid over the next 12 months.

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For further details regarding our restructuring activities, refer to Item 1: “Financial Statements, Note 12: Restructuring.”

Other Liquidity Considerations

We have tax credits and net operating loss carryforwards in various jurisdictions that are available to reduce cash taxes. However, utilization of tax credits and net operating losses are limited in certain jurisdictions. Based on current projections, we expect to pay, net of refunds, approximately $5 million in state taxes, $9 million in U.S federal taxes, and $14 million in local and foreign taxes during 2016. For a discussion of our tax provision and unrecognized tax benefits, see Item 1: “Financial Statements, Note 10: Income Taxes.”

At September 30, 2016, we are under examination by certain tax authorities for the 2000 to 2014 tax years. The material jurisdictions where we are subject to examination include, among others, the United States, France, Germany, Italy, Brazil, and the United Kingdom. No material changes have occurred to previously disclosed assessments. We believe we have appropriately accrued for the expected outcome of all tax matters and do not currently anticipate that the ultimate resolution of these examinations will have a material adverse effect on our financial condition, future results of operations, or liquidity.

We have not provided U.S. deferred taxes related to the cash in certain foreign subsidiaries because our investment is considered permanent in duration. As of September 30, 2016, there was $36.5 million of cash and short-term investments held by certain foreign subsidiaries in which we are permanently reinvested for tax purposes. If this cash were repatriated to fund U.S. operations, additional tax costs may be required. Tax is one of the many factors that we consider in the management of global cash. Included in the determination of the tax costs in repatriating foreign cash into the United States are the amount of earnings and profits in a particular jurisdiction, withholding taxes that would be imposed, and available foreign tax credits. Accordingly, the amount of taxes that we would need to accrue and pay to repatriate foreign cash could vary significantly.

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, Inc., we consolidate them because we have a greater than 50% ownership interest and/or because we exercise control over the operations. 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. Approximately $21.6 million of our consolidated cash balance at September 30, 2016 is held in our joint venture entities. As a result, the minority shareholders of these entities have rights to their proportional share of this cash balance, and there may be limitations on our ability to repatriate cash to the United States from these entities.

At September 30, 2016, we have accrued $18.2 million of bonus and profit sharing plans expense for the expected achievement of annual financial and nonfinancial targets, which will be paid in cash during the first quarter of 2017.

General Liquidity Overview

We expect to grow through a combination of internal new product development, licensing technology from and to others, distribution agreements, partnering arrangements, and acquisitions of technology or other companies. We expect these activities to be funded with existing cash, cash flow from operations, borrowings, or the sale of common stock or other securities. We believe existing sources of liquidity will be sufficient to fund our existing operations and obligations for the next 12 months and into the foreseeable future, but offer no assurances. Our liquidity could be affected by the stability of the electricity, gas, and water industries, competitive pressures, changes in estimated liabilities for product warranties and/or litigation, future business combinations, capital market fluctuations, international risks, and other factors described under “Risk Factors” within Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, which was filed with the SEC on June 30, 2016, as well as “Quantitative and Qualitative Disclosures About Market Risk” within Item 3 of Part I included in this Quarterly Report on Form 10-Q.

Contingencies

Refer to Item 1: “Financial Statements, Note 11: Commitments and Contingencies.”

Critical Accounting Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Changes in these estimates and assumptions are considered reasonably possible and may have a material effect on our consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein. Our critical accounting policies that require the use of estimates and assumptions were discussed in detail in the 2015 Annual Report on Form 10-K and have not changed materially from that discussion, with the following exception.

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Stock-Based Compensation

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

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

We expense stock-based compensation at the date of grant for unrestricted stock awards. For awards with only a service condition, we expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the requisite service period for the entire award. For awards with performance and service conditions, if vesting is probable, we expense the stock-based compensation, adjusted for estimated forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the award. For awards with a market condition, we expense the fair value over the requisite service period. Excess tax benefits are credited to common stock when the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the Consolidated Statements of Cash Flows.

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Non-GAAP Measures

Our consolidated financial statements are prepared in accordance with GAAP, which we supplement with certain non-GAAP financial information. These non-GAAP measures should not be considered in isolation or as a substitute for the related GAAP measures, and other companies may define such measures differently. We encourage investors to review our financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure. These non-GAAP measures exclude the impact of certain expenses that we do not believe are indicative of our core operating results. We use these non-GAAP financial measures for financial and operational decision making and as a means for determining executive compensation. These non-GAAP financial measures facilitate management's internal comparisons to our historical performance.

Non-GAAP operating expenses and non-GAAP operating income – We define non-GAAP operating expenses as operating expenses excluding certain expenses related to the amortization of intangible assets, restructuring, acquisitions and goodwill impairment. We define non-GAAP operating income as operating income excluding the expenses related to the amortization of intangible assets, restructuring, acquisitions and goodwill impairment. We consider these non-GAAP financial measures to be useful metrics for management and investors because they exclude the effect of expenses that are related to previous acquisitions and restructuring projects. By excluding these expenses, we believe that it is easier for management and investors to compare our financial results over multiple periods and analyze trends in our operations. For example, in certain periods expenses related to amortization of intangible assets may decrease, which would improve GAAP operating margins, yet the improvement in GAAP operating margins due to this lower expense is not necessarily reflective of an improvement in our core business. There are some limitations related to the use of non-GAAP operating expense and non-GAAP operating income versus operating expense and operating income calculated in accordance with GAAP. Non-GAAP operating expense and non-GAAP operating income exclude some costs that are recurring.

Non-GAAP net income and non-GAAP diluted EPS – We define non-GAAP net income as net income (loss) attributable to Itron, Inc. excluding the expenses associated with amortization of intangible assets, restructuring, acquisitions, goodwill impairment, amortization of debt placement fees, and the tax effect of excluding these expenses. We define non-GAAP diluted EPS as non-GAAP net income divided by the weighted average shares, on a diluted basis, outstanding during each period. We consider these financial measures to be useful metrics for management and investors for the same reasons that we use non-GAAP operating income. The same limitations described above regarding our use of non-GAAP operating income apply to our use of non-GAAP net income and non-GAAP diluted EPS. We compensate for these limitations by providing specific information regarding the GAAP amounts excluded from these non-GAAP measures and evaluating non-GAAP net income and non-GAAP diluted EPS together with GAAP net income (loss) attributable to Itron, Inc. and GAAP diluted EPS.

Adjusted EBITDA – We define adjusted EBITDA as net income (a) minus interest income, (b) plus interest expense, depreciation, amortization of intangible assets, restructuring, acquisition related expense, goodwill impairment and (c) exclude the tax expense or benefit. We believe that providing this financial measure is important for management and investors to understand our ability to service our debt as it is a measure of the cash generated by our core business. Management uses adjusted EBITDA as a performance measure for executive compensation. A limitation to using adjusted EBITDA is that it does not represent the total increase or decrease in the cash balance for the period and the measure includes some non-cash items and excludes other non-cash items. Additionally, the items that we exclude in our calculation of adjusted EBITDA may differ from the items that our peer companies exclude when they report their results. We compensate for these limitations by providing a reconciliation of this measure to GAAP net income.

Free cash flow - We define free cash flow as net cash provided by operating activities less cash used for acquisitions of property, plant and equipment. We believe free cash flow provides investors with a relevant measure of liquidity and a useful basis for assessing our ability to fund our operations and repay our debt. The same limitations described

above regarding our use of adjusted EBITDA apply to our use of free cash flow. We compensate for these limitations by providing specific information regarding the GAAP amounts and reconciling to free cash flow.

Constant currency - We refer to the impact of foreign currency exchange rate fluctuations in our discussions of financial results, which references the differences between the foreign currency exchange rates used to translate operating results from local currencies into U.S. dollars for financial reporting purposes. We also use the term "constant currency," which represents financial results adjusted to exclude changes in foreign currency exchange rates as compared with the rates in the comparable prior year period. We calculate the constant currency change as the difference between the current period results and the comparable prior period's results restated using current period foreign currency exchange rates.

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Reconciliation of GAAP Measures to Non-GAAP Measures

The table below reconciles the non-GAAP financial measures of operating expenses, operating income, net income, diluted EPS, adjusted EBITDA, free cash flow, and operating income by segment with the most directly comparable GAAP financial measures.

TOTAL COMPANY RECONCILIATIONS	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands, except per share data)			
NON-GAAP OPERATING EXPENSES				
GAAP operating expenses	$164,339	$120,350	$438,200	$367,798
Amortization of intangible assets	(4,996)	(7,869)	(19,002)	(23,730)
Restructuring	(40,679)	(587)	(41,294)	8,828
Acquisition-related expenses	180	3,271	202	5,554
Non-GAAP operating expenses	$118,844	$115,165	$378,106	$358,450
NON-GAAP OPERATING INCOME				
GAAP operating income	$6,410	$26,940	$65,457	$36,468
Amortization of intangible assets	4,996	7,869	19,002	23,730
Restructuring	40,679	587	41,294	(8,828)
Acquisition-related expenses	(180)	(3,271)	(202)	(5,554)
Non-GAAP operating income	$51,905	$32,125	$125,551	$45,816
NON-GAAP NET INCOME & DILUTED EPS				
GAAP net income (loss) attributable to Itron, Inc.	$(9,885)	$12,640	$20,121	$3,692
Amortization of intangible assets	4,996	7,869	19,002	23,730
Amortization of debt placement fees	247	244	742	1,773
Restructuring	40,679	587	41,294	(8,828)
Acquisition-related expenses	(180)	(3,271)	(202)	(5,554)
Income tax effect of non-GAAP adjustments[1]	(5,961)	(1,095)	(9,086)	(4,198)
Non-GAAP net income attributable to Itron, Inc.	$29,896	$16,974	$71,871	$10,615
Non-GAAP diluted EPS	$0.77	$0.44	$1.87	$0.28
Weighted average common shares outstanding - Diluted	38,651	38,358	38,515	38,591
ADJUSTED EBITDA				
GAAP net income (loss) attributable to Itron, Inc.	$(9,885)	$12,640	$20,121	$3,692
Interest income	(102)	(180)	(594)	(440)
Interest expense	2,691	2,799	8,344	9,336
Income tax provision	13,430	9,932	34,249	19,060
Depreciation and amortization	16,082	18,998	51,563	57,790
Restructuring	40,679	587	41,294	(8,828)
Acquisition-related expenses	(180)	(3,271)	(202)	(5,554)
Adjusted EBITDA	$62,715	$41,505	$154,775	$75,056

FREE CASH FLOW				
Net cash provided by operating activities	$30,754	$2,587	$81,881	$20,154
Acquisitions of property, plant, and equipment	(10,679)	(12,332)	(30,563)	(33,324)
Free Cash Flow	$20,075	$(9,745)	$51,318	$(13,170)

(1) The income tax effect of non-GAAP adjustments is calculated using the statutory tax rates for the relevant jurisdictions if no valuation allowance exists. If a valuation allowance exists, there is no tax impact to the non-GAAP adjustment.

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SEGMENT RECONCILIATIONS	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
NON-GAAP OPERATING INCOME - ELECTRICITY				
Electricity - GAAP operating income	$20,452	$9,819	$51,092	$14,958
Amortization of intangible assets	2,183	4,413	10,050	13,296
Restructuring	6,443	(1,678)	5,411	(7,143)
Acquisition-related expenses	(180)	(3,390)	(202)	(5,673)
Electricity - Non-GAAP operating income	$28,898	$9,164	$66,351	$15,438
NON-GAAP OPERATING INCOME - GAS				
Gas - GAAP operating income	$7,136	$15,836	$48,811	$44,986
Amortization of intangible assets	1,513	1,950	4,888	5,865
Restructuring	20,738	160	21,990	(901)
Gas - Non-GAAP operating income	$29,387	$17,946	$75,689	$49,950
NON-GAAP OPERATING INCOME - WATER				
Water - GAAP operating income (loss)	$(3,546)	$14,265	$28,707	$11,415
Amortization of intangible assets	1,300	1,506	4,064	4,569
Restructuring	12,414	273	12,465	546
Acquisition-related expenses	—	104	—	104
Water - Non-GAAP operating income	$10,168	$16,148	$45,236	$16,634
NON-GAAP OPERATING INCOME - CORPORATE UNALLOCATED				
Corporate unallocated - GAAP operating loss	$(17,632)	$(12,980)	$(63,153)	$(34,891)
Restructuring	1,084	1,832	1,428	(1,330)
Acquisition-related expenses	—	15	—	15
Corporate unallocated - Non-GAAP operating loss	$(16,548)	$(11,133)	$(61,725)	$(36,206)

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Item 3: Quantitative and Qualitative Disclosures about Market Risk

In the normal course of business, we are exposed to interest rate and foreign currency exchange rate risks that could impact our financial position and results of operations. As part of our risk management strategy, we may use derivative financial instruments to hedge certain foreign currency and interest rate exposures. Our objective is to offset gains and losses resulting from these exposures with losses and gains on the derivative contracts used to hedge them, therefore reducing the impact of volatility on earnings or protecting the fair values of assets and liabilities. We use derivative contracts only to manage existing underlying exposures. Accordingly, we do not use derivative contracts for trading or speculative purposes.

Interest Rate Risk

We are exposed to interest rate risk through our variable rate debt instruments. 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 were effective from July 31, 2013 to August 8, 2016.

In October 2015, we entered into an interest rate swap, which is effective from August 31, 2016 to June 23, 2020, and converts $214 million of our LIBOR-based debt from a floating LIBOR interest rate to a fixed interest rate of 1.42% (excluding the applicable margin on the debt). The notional balance will amortize to maturity at the same rate as required minimum payments on our term loan. At September 30, 2016, our LIBOR-based debt balance was $290.9 million.

In November 2015, we entered into three interest rate cap contracts with a total notional amount of $100 million at a cost of $1.7 million. The interest rate cap contracts expire on June 23, 2020 and were entered into in order to limit our interest rate exposure on $100 million of our variable LIBOR-based debt up to 2.00%. In the event LIBOR is higher than 2.00%, we will pay interest at the capped rate of 2.00% with respect to the $100 million notional amount of such agreements. The interest rate cap contracts do not include the effect of the applicable margin.

The table below provides information about our financial instruments that are sensitive to changes in interest rates and the scheduled minimum repayment of principal and the weighted average interest rates at September 30, 2016. Weighted average variable rates in the table are based on implied forward rates in the Reuters U.S. dollar yield curve as of September 30, 2016 and our estimated leverage ratio, which determines our additional interest rate margin at September 30, 2016.

	2016	2017	2018	2019	2020	Total	Fair Value
	(in thousands)						
Variable Rate Debt							
Principal: U.S. dollar term loan	$2,813	$14,063	$19,688	$22,500	$151,874	$210,938	$209,317
Average interest rate	1.80 %	2.01 %	2.17 %	2.29 %	2.40 %		
Principal: Multicurrency revolving line of credit	$—	$—	$—	$—	$132,597	$132,597	$131,387
Average interest rate	1.58 %	1.71 %	1.80 %	1.88 %	1.94 %		
Interest rate swap on LIBOR-based debt							
Average interest rate (pay)	1.42 %	1.42 %	1.42 %	1.42 %	1.42 %		
Average interest rate (receive)	0.56 %	0.76 %	0.92 %	1.05 %	1.15 %		

Net/Spread	(0.86)%	(0.66)%	(0.50)%	(0.37)%	(0.27)%

Based on a sensitivity analysis as of September 30, 2016, we estimate that, if market interest rates average one percentage point higher in 2016 than in the table above, our financial results in 2016 would not be materially impacted.

We continually 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.

Foreign Currency Exchange Rate Risk

We conduct business in a number of countries. As a result, approximately half of our revenues and operating expenses are denominated in foreign currencies, which expose our account balances to movements in foreign currency exchange rates that could have a material effect on our financial results. Our primary foreign currency exposure relates to non-U.S. dollar denominated transactions in our international subsidiary operations, the most significant of which is the euro. Revenues denominated in functional

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currencies other than the U.S. dollar were 44% and 47% of total revenues for the three and nine months ended September 30, 2016 compared with 49% and 51% for the same respective periods in 2015.

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

In future periods, we may use additional derivative contracts to protect against foreign currency exchange rate risks.

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Item 4: Controls and Procedures

(a) Evaluation of disclosure controls and procedures. An evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e)) under the Securities Exchange Act of 1934, as amended. These disclosure controls and procedures ensure the information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that as of September 30, 2016, the Company's disclosure controls and procedures were not effective as a result of a material weakness in our internal control over financial reporting identified during the year ended December 31, 2015, as disclosed in our 2015 Annual Report on Form 10-K. Specifically, we did not design and maintain effective controls to determine whether vendor specific objective evidence (VSOE) of fair value could be demonstrated for substantially all maintenance contracts associated with certain software solutions and whether software was essential to the functionality of certain hardware. Management has concluded that the deficiencies identified in our revenue processes and controls, the combination of which represents a material weakness, were also present as of September 30, 2016, as our remediation efforts have not yet been completed.

(b) Changes in internal controls over financial reporting. In the ordinary course of business, we review our system of internal control over financial reporting and make changes to our applications and processes to improve such controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient applications and automating manual processes. We are currently upgrading our global enterprise resource software applications at our locations outside of the United States. We will continue to upgrade our financial applications in stages, and we believe the related changes to processes and internal controls will allow us to be more efficient and further enhance our internal control over financial reporting.

Additionally, we have established a shared services center in Europe, and we are currently transitioning certain finance and accounting activities within all regions to the shared services center in a staged approach. The transition to shared services is ongoing, and we believe the related changes to processes and internal controls will allow us to be more efficient and further enhance our internal control over financial reporting.
Except for these changes and the remediation efforts related to the material weakness noted below, there have been no other changes in our internal control over financial reporting during the three months ended September 30, 2016 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

(c) Remediation of Material Weakness in Internal Controls over Financial Reporting. To remediate the material weakness in our internal controls over financial reporting described above, substantial progress has been made with the following:

- Implementing control design changes;
- Developing a plan to implement operational effectiveness testing during the fourth quarter of 2016;
- Updating revenue recognition policies and procedures;
- Hiring additional resources with revenue accounting expertise;

- Completing training for revenue accounting employees and other employees directly associated with sales contracts; and
- Utilizing external advisers to assist with technical matters related to complex sales contracts.

When fully implemented and operational, we believe the measures described above will remediate the material weakness we have identified and strengthen our internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1: Legal Proceedings
Refer to Item 1: “Financial Statements, Note 11: Commitments and Contingencies.”

Item 1A: Risk Factors
There were no material changes to risk factors during the third quarter of 2016 from those previously disclosed in Item 1A: “Risk Factors” of Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, which was filed with the SEC on June 30, 2016.

Item 2: Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable.

(b) Not applicable.

(c) Not applicable.

Item 5: Other Information

(a) No information was required to be disclosed in a report on Form 8-K during the third quarter of 2016 that was not reported.

(b) Not applicable.

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Item 6: Exhibits

Exhibit Number	Description of Exhibits
10.1	Amendment to the Itron, Inc. Executive Deferred Compensation Plan. (filed with this report)
10.2	Amendment to Cooperation Agreement with Coppersmith Capital Management and Scopia Capital Management. (filed with this report)
12.1	Computation of Ratio of Earnings to Fixed Charges. (filed with this report)
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

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SIGNATURE

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.

ITRON, INC.

November 3, 2016 By: /s/ W. MARK SCHMITZ
Date W. Mark Schmitz
Executive Vice President and Chief Financial Officer