

ITRON INC /WA/

Form 10-Q

November 06, 2018

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

## FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

<sup>o</sup> 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 ☒ No ☐

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Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

As of October 31, 2018, there were outstanding 39,416,335 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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Table of Contents**PART I: FINANCIAL INFORMATION****Item 1: Financial Statements (Unaudited)****ITRON, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
	<b>(in thousands, except per share data)</b>			
Revenues				
Product revenues	\$525,716	\$433,984	\$1,578,740	\$1,321,062
Service revenues	70,246	52,763	210,333	146,359
Total revenues	595,962	486,747	1,789,073	1,467,421
Cost of revenues				
Product cost of revenues	357,194	284,762	1,106,586	865,288
Service cost of revenues	41,671	36,230	128,958	100,464
Total cost of revenues	398,865	320,992	1,235,544	965,752
Gross profit	197,097	165,755	553,529	501,669
Operating expenses				
Sales and marketing	47,204	40,529	144,573	126,298
Research and development	47,239	42,455	162,298	126,246
General and administrative	42,352	39,598	188,260	119,883
Amortization of intangible assets	17,960	5,625	53,699	15,144
Restructuring	666	(678)	82,908	7,417
Total operating expenses	155,421	127,529	631,738	394,988
Operating income (loss)	41,676	38,226	(78,209)	106,681
Other income (expense)				
Interest income	431	729	1,725	1,468
Interest expense	(14,171)	(3,466)	(44,320)	(10,076)
Other income (expense), net	(2,434)	(1,995)	(2,598)	(7,951)
Total other income (expense)	(16,174)	(4,732)	(45,193)	(16,559)
Income (loss) before income taxes	25,502	33,494	(123,402)	90,122
Income tax benefit (provision)	(5,715)	(6,640)	1,692	(32,247)
Net income (loss)	19,787	26,854	(121,710)	57,875
Net income (loss) attributable to noncontrolling interests	(95)	1,278	1,417	2,357
Net income (loss) attributable to Itron, Inc.	\$19,882	\$25,576	\$(123,127)	\$55,518
Earnings (loss) per common share - Basic	\$0.51	\$0.66	\$(3.14)	\$1.44
Earnings (loss) per common share - Diluted	\$0.50	\$0.65	\$(3.14)	\$1.41
Weighted average common shares outstanding - Basic	39,340	38,713	39,177	38,624
Weighted average common shares outstanding - Diluted	39,909	39,467	39,177	39,339

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



Table of Contents**ITRON, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**(UNAUDITED)**

	Three Months Ended September 30, 2018		2017		Nine Months Ended September 30, 2018		2017	
	(in thousands)							
Net income (loss)	\$19,787	\$26,854	\$(121,710)	)	\$57,875			
Other comprehensive income, net of tax:								
Foreign currency translation adjustments	(678	)	14,930		(18,538	)	50,393	
Net unrealized gain (loss) on derivative instruments, designated as cash flow hedges	908		126		2,563		187	
Pension benefit obligation adjustment	392		410		1,207		1,004	
Total other comprehensive income (loss), net of tax	622		15,466		(14,768	)	51,584	
Total comprehensive income (loss), net of tax	20,409		42,320		(136,478	)	109,459	
Comprehensive income (loss) attributable to noncontrolling interests, net of tax	(95	)	1,278		1,417		2,357	
Comprehensive income (loss) attributable to Itron, Inc.	\$20,504	\$41,042	\$(137,895)	)	\$107,102			
The accompanying notes are an integral part of these condensed consolidated financial statements.								

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

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**ITRON, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

	<b>September 30,</b>	<b>December 31,</b>
	<b>2018</b>	<b>2017</b>
	<b>(in thousands)</b>	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 109,044	\$ 176,274
Accounts receivable, net	449,592	398,029
Inventories	208,038	193,835
Other current assets	101,511	81,604
Total current assets	868,185	849,742
Property, plant, and equipment, net	220,795	200,768
Deferred tax assets, net	56,874	49,971
Restricted cash	2,055	311,010
Other long-term assets	48,746	43,666
Intangible assets, net	278,192	95,228
Goodwill	1,121,895	555,762
Total assets	\$ 2,596,742	\$ 2,106,147
<b>LIABILITIES AND EQUITY</b>		
Current liabilities		
Accounts payable	\$ 274,950	\$ 262,166
Other current liabilities	72,385	56,736
Wages and benefits payable	101,491	90,505
Taxes payable	20,558	16,100
Current portion of debt	24,375	19,688
Current portion of warranty	29,736	21,150
Unearned revenue	92,350	41,438
Total current liabilities	615,845	507,783
Long-term debt	1,005,377	593,572
Long-term warranty	13,624	13,712
Pension benefit obligation	96,081	95,717
Deferred tax liabilities, net	1,462	1,525
Other long-term obligations	152,021	88,206
Total liabilities	1,884,410	1,300,515
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, 39,400 and 38,771 shares issued and outstanding	1,326,719	1,294,767
Accumulated other comprehensive loss, net	(185,246 )	(170,478 )

Accumulated deficit	(449,273 )	(337,873 )
Total Itron, Inc. shareholders' equity	692,200	786,416
Noncontrolling interests	20,132	19,216
Total equity	712,332	805,632
Total liabilities and equity	\$2,596,742	\$ 2,106,147

*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,**  
**2018          2017**

(in thousands)

Operating activities		
Net income (loss)	\$ (121,710 )	\$ 57,875
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	92,428	46,000
Stock-based compensation	23,069	15,254
Amortization of prepaid debt fees	5,825	800
Deferred taxes, net	(13,141 )	7,615
Restructuring, non-cash	569	(720 )
Other adjustments, net	(30 )	3,111
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	7,774	2,537
Inventories	(10,072 )	(30,843 )
Other current assets	(9,797 )	(23,492 )
Other long-term assets	3,817	10,460
Accounts payable, other current liabilities, and taxes payable	4,494	34,987
Wages and benefits payable	2,166	6,218
Unearned revenue	27,869	(5,679 )
Warranty	3,167	(10,285 )
Other operating, net	50,955	663
Net cash provided by operating activities	67,383	114,501
Investing activities		
Acquisitions of property, plant, and equipment	(42,493 )	(33,493 )
Business acquisitions, net of cash equivalents acquired	(803,075 )	(98,848 )
Other investing, net	(181 )	10
Net cash used in investing activities	(845,749 )	(132,331 )
Financing activities		
Proceeds from borrowings	611,938	35,000
Payments on debt	(182,297 )	(24,844 )
Issuance of common stock	8,283	2,797
Prepaid debt fees	(24,042 )	—
Other financing, net	(5,526 )	1,216
Net cash provided by financing activities	408,356	14,169
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash	(6,175 )	7,680
(Decrease) increase in cash, cash equivalents, and restricted cash	(376,185 )	4,019
Cash, cash equivalents, and restricted cash at beginning of period	487,335	133,565
Cash, cash equivalents, and restricted cash at end of period	\$ 111,150	\$ 137,584

*Supplemental disclosure of cash flow information:*

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Cash paid during the period for:

Income taxes, net	\$ 6,367	\$ 25,423
Interest	34,539	7,629

*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, 2018**

**(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, 2018 and 2017, the Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 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, 2018 are not necessarily indicative of the results expected for the full year or for any other 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 2017 Annual Report on Form 10-K filed with the SEC on

February 28, 2018. There have been no significant changes in financial statement preparation or significant accounting policies since December 31, 2017, with the exception of the adoption of Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers* (ASC 606).

On January 1, 2018, we adopted ASC 606 using the modified retrospective method applied to those contracts that were not completed. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC 605, *Revenue Recognition* (ASC 605). The cumulative impact of adoption was a net decrease to accumulated deficit of \$10.9 million as of January 1, 2018, with the impact primarily related to multiple element arrangements that contain software and software related elements. As we had not established vendor specific objective evidence of fair value for certain of our software and software related elements, we historically combined them as one unit of account and recognized the combined unit of account using the combined services approach. Under ASC 606, these software and software related elements are generally determined to be distinct performance obligations. As such, we are able to recognize revenue as we satisfy the performance obligations, either at a point in time or over time. For contracts that were modified prior to January 1, 2018, we have reflected the aggregate effect of all modifications prior to the date of initial adoption in order to identify the satisfied and unsatisfied performance obligations, determine the transaction price, and allocate the transaction price to satisfied and unsatisfied performance obligations. The impact to revenues for the three and nine months ended September 30, 2018 was immaterial as a result of applying ASC 606.

Refer to the updated Revenue Recognition accounting policy described below and Note 16 for additional disclosures regarding our revenues from contracts with customers and the adoption of ASC 606.

*Reclassifications*

Certain reclassifications have been made to prior period consolidated financial statements to conform to classifications used in the current period. These reclassifications had no impact on net income (loss), shareholders' equity or cash flows as previously reported.

*Restricted Cash and Cash Equivalents*

Cash and cash equivalents that are contractually restricted from operating use are classified as restricted cash and cash equivalents.

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The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the Consolidated Balance Sheets that sum to the total of the same such amounts shown in the Consolidated Statements of Cash Flows:

	September 30, 2018	December 31, 2017	September 30, 2017
	(in thousands)		
Cash and cash equivalents	\$ 109,044	\$ 176,274	\$ 137,584
Current restricted cash included in other current assets	51	51	—
Long-term restricted cash	2,055	311,010	—
Total cash, cash equivalents, and restricted cash	\$ 111,150	\$ 487,335	\$ 137,584

*Revenue Recognition*

The majority of our revenues consist primarily of hardware sales, but may also include the license of software, software implementation services, cloud services and software as a service ("SaaS"), project management services, installation services, consulting services, post-sale maintenance support, and extended or noncustomary warranties. We account for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance, and collectability of consideration is probable. In determining whether the definition of a contract has been met, we will consider whether the arrangement creates enforceable rights and obligations, which involves evaluation of agreement terms that would allow for the customer to terminate the agreement. If the customer is able to terminate the agreement without providing further consideration to us, the agreement would not be considered to meet the definition of a contract.

Many of our revenue arrangements involve multiple performance obligations consisting of hardware, meter reading system software, installation, and/or project management services. Separate contracts entered into with the same customer (or related parties of the customer) at or near the same time are accounted for as a single contract where one or more of the following criteria are met:

- The contracts are negotiated as a package with a single commercial objective;
- The amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

Once the contract has been defined, we evaluate whether the promises in the contract should be accounted for as more than one performance obligation. This evaluation requires significant judgment, and the decision to separate the combined or single contract into multiple performance obligations could change the amount of revenue and profit recognized in a given period. For some of our contracts, the customer contracts with us to provide a significant service of integrating, customizing or modifying goods or services in the contract in which case the goods or services would be combined into a single performance obligation. It is common that we may promise to provide multiple distinct goods or services within a contract in which case we separate the contract into more than one performance obligation. If a contract is separated into more than one performance obligation, we allocate the total transaction price to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised goods or services underlying each performance obligation. If applicable, for goods or services where we have observable standalone sales, the observable standalone sales are used to determine the standalone selling price. For the majority of our goods and services, we do not have observable standalone sales. As a result, we estimate the standalone selling price using either the adjusted market assessment approach or the expected cost plus a margin approach. Approaches used to estimate the standalone selling price for a given good or service will maximize the use of observable inputs and considers several factors, including our pricing practices, costs to provide a good or service, the type of good or service, and availability of other transactional data, among others.

We determine the estimated standalone selling prices of goods or services used in our allocation of arrangement consideration on an annual basis or more frequently if there is a significant change in our business or if we experience significant variances in our transaction prices.

Many of our contracts with customers include variable consideration, which can include liquidated damage provisions, rebates and volume and early payment discounts. Some of our contracts with customers contain clauses for liquidated damages related to the timing of delivery or milestone accomplishments, which could become material in an event of failure to meet the contractual deadlines. At the inception of the arrangement and on an ongoing basis, we evaluate the probability and magnitude of having to pay liquidated damages. We estimate variable consideration using the expected value method, taking into consideration contract terms, historical customer behavior and historical sales. In the case of liquidated damages, we also take into consideration progress towards meeting contractual milestones, including whether milestones have not been achieved, specified rates, if applicable, stated

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in the contract, and history of paying liquidated damages to the customer or similar customers. Variable consideration is included in the transaction price if, in our judgment, it is probable that a significant future reversal of cumulative revenue under the contract will not occur.

In the normal course of business, we do not accept product returns unless the item is defective as manufactured. We establish provisions for estimated returns and warranties. In addition, we do not typically provide customers with the right to a refund.

Hardware revenues are recognized at a point in time. Transfer of control is typically at the time of shipment, receipt by the customer, or, if applicable, upon receipt of customer acceptance provisions. We will recognize revenue prior to receipt of customer acceptance for hardware in cases where the customer acceptance provision is determined to be a formality. Transfer of control would not occur until receipt of customer acceptance in hardware arrangements where such provisions are subjective or where we do not have history of meeting the acceptance criteria.

Perpetual software licenses are considered to be a right to use intellectual property and are recognized at a point in time. Transfer of control is considered to be at the point at which it is available to the customer to download and use or upon receipt of customer acceptance. In certain contracts, software licenses may be sold with professional services that include implementation services that include a significant service of integrating, customizing or modifying the software. In these instances, the software license is combined into single performance obligation with the implementation services and recognized over time as the implementation services are performed.

Hardware and software licenses (when not combined with professional services) are typically billed when shipped and revenue recognized at a point-in-time. As a result, the timing of revenue recognition and invoicing does not have a significant impact on contract assets and liabilities.

Professional services, which include implementation, project management, installation, and consulting services are recognized over time. We measure progress towards satisfying these performance obligations using input methods, most commonly based on the costs incurred in relation to the total expected costs to provide the service. We expect this method to best depict our performance in transferring control of services promised to the customer or represents a reasonable proxy for measuring progress. The estimate of expected costs to provide services requires judgment. Cost estimates take into consideration past history and the specific scope requested by the customer and are updated quarterly. We may also offer professional services on a stand-ready basis over a specified period of time, in which case revenue would be recognized ratably over the term. Invoicing of these services is commensurate with performance and occurs on a monthly basis. As such, these services do not have a significant impact on contract assets and contract liabilities.

Cloud services and SaaS arrangements where customers have access to certain of our software within a cloud-based IT environment that we manage, host and support are offered to customers on a subscription basis. Revenue for the cloud services and SaaS offerings are generally recognized over time, ratably over the contract term commencing with the date the services are made available to the customer.

Services, including professional services, cloud services and SaaS arrangements, are commonly billed on a monthly basis in arrears and typically result in an unbilled receivable, which is not considered a contract asset as our right to consideration is unconditional.

Certain of our revenue arrangements include an extended or noncustomary warranty provisions that covers all or a portion of a customer's replacement or repair costs beyond the standard or customary warranty period. Whether or not the extended warranty is separately priced in the arrangement, such warranties are considered to be a separate good or service, and a portion of the transaction price is allocated to this extended warranty performance obligation. This

revenue is recognized, ratably over the extended warranty coverage period.

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

Payment terms with customers can vary by customer; however, amounts billed are typically payable within 30 to 90 days, depending on the destination country. We do not make a practice of offering financing as part of our contracts with customers.

We incur certain incremental costs to obtain contracts with customers, primarily in the form of sales commissions. Where the amortization period is one year or less, we have elected to apply the practical expedient and recognize the related commissions

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expense as incurred. Otherwise, such incremental costs are capitalized and amortized over the contract period. Capitalized incremental costs are not material.

### *New Accounting Pronouncements*

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)* (ASU 2016-02), 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. In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic 842, Leases* (ASU 2018-10), to clarify, improve, and correct various aspects of ASU 2016-02, and also issued ASU 2018-11, *Targeted Improvements to Topic 842, Leases* (ASU 2018-11), to simplify transition requirements and, for lessors, provide a practical expedient for the separation of nonlease components from lease components. The effective date and transition requirements in ASU 2018-10 and ASU 2018-11 are the same as the effective date and transition requirements of ASU 2016-02. We currently believe the most significant impact relates to our real estate leases and the increased financial statement disclosures, but are continuing to evaluate the effect that the updated standard will have on our consolidated results of operations, financial position, cash flows, and related financial statement disclosures.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326)* (ASU 2016-13), which replaces the incurred loss impairment methodology in current GAAP with a methodology based on expected credit losses. This estimate of expected credit losses uses a broader range of reasonable and supportable information. This change will result in earlier recognition of credit losses. ASU 2016-13 is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2019. We are currently evaluating the impact of this standard on our consolidated financial statements, including accounting policies, processes, and systems.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory (Topic 740)* (ASU 2016-16), which removes the prohibition in ASC 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. Under ASU 2016-16, the selling entity is required to recognize a current tax expense or benefit upon transfer of the asset. Similarly, the purchasing entity is required to recognize a deferred tax asset or deferred tax liability, as well as the related deferred tax benefit or expense, upon receipt of the asset. The resulting deferred tax asset or deferred tax liability is measured by computing the difference between the tax basis of the asset in the buyer's jurisdiction and its financial reporting carrying value in the consolidated financial statements and multiplying such difference by the enacted tax rate in the buyer's jurisdiction. ASU 2016-16 is effective for fiscal years beginning after December 15, 2017 with early adoption permitted. We adopted this standard effective January 1, 2018 using the modified retrospective transition method, recognizing a \$0.9 million one-time decrease to accumulated deficit.

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* (ASU 2017-07), which provides additional guidance on the presentation of net benefit costs in the income statement. ASU 2017-07 requires an employer disaggregate the service cost component from the other components of net benefit cost and to disclose other components outside of a subtotal of income from operations. It also allows only the service cost component of net benefit costs to be eligible for capitalization. ASU 2017-07 is effective for fiscal years beginning after December 15, 2017 with early adoption permitted.

We adopted this standard on January 1, 2018 retrospectively for the presentation of the service cost component of net periodic pension cost in the statement of operations, and prospectively for the capitalization of the service cost component of net periodic pension cost. For applying the retrospective presentation requirements, we elected to utilize

amounts previously disclosed in our defined benefit pension plan footnote for the prior comparative periods as the estimation basis for applying the retrospective presentation. This resulted in a reclassification of an immaterial amount of net periodic pension benefit costs from operating income to other income (expense) in all periods presented on the Consolidated Statements of Operations.

In August 2017, the FASB issued ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities* (ASU 2017-12), which amends and simplifies existing guidance in order to allow companies to more accurately present the economic effects of risk management activities in the financial statements. This update expands and refines hedge accounting for both nonfinancial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. Additionally, the amendments in ASU 2017-12 provide new guidance about income statement classification and eliminates the requirement to separately measure and report hedge ineffectiveness. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. We adopted this standard on April 1, 2018 and



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it did not materially impact our consolidated results of operations, financial position, cash flows, or related financial statement disclosures.

In August 2018, the FASB issued ASU 2018-13, *Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* (ASU 2018-13) which amends the disclosure requirements under ASC 820, *Fair Value Measurements*. ASU 2018-13 is effective for us beginning with our interim financial reports for the first quarter of 2020.

In August 2018, the FASB issued ASU 2018-14, *Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans* (ASU 2018-14) which amends the disclosure requirements under ASC 715-20, *Compensation—Retirement Benefits—Defined Benefit Plans*. ASU 2018-14 is effective for our financial reporting in 2020.

**Note 2: Earnings Per Share**

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
	<b>(in thousands, except per share data)</b>			
Net income (loss) available to common shareholders	\$ 19,882	\$ 25,576	\$ (123,127 )	\$ 55,518
Weighted average common shares outstanding - Basic	39,340	38,713	39,177	38,624
Dilutive effect of stock-based awards	569	754	—	715
Weighted average common shares outstanding - Diluted	39,909	39,467	39,177	39,339
Earnings (loss) per common share - Basic	\$0.51	\$0.66	\$(3.14 )	\$1.44
Earnings (loss) per common share - Diluted	\$0.50	\$0.65	\$(3.14 )	\$1.41

*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 and the future compensation cost associated with the stock award. Approximately 0.5 million and 1.1 million stock-based awards were excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2018, respectively, because they were anti-dilutive. Approximately 0.2 million stock-based awards were excluded from the calculation of diluted EPS for both the three and nine months ended September 30, 2017 because they were anti-dilutive. These stock-based awards could be dilutive in future periods.

**Note 3: Certain Balance Sheet Components**

A summary of accounts receivable from contracts with customers is as follows:

	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b>(in thousands)</b>	
Trade receivables (net of allowance of \$3,822 and \$3,957)	\$ 422,567	\$ 369,047
Unbilled receivables	27,025	28,982
Total accounts receivable, net	\$ 449,592	\$ 398,029



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<i>Allowance for doubtful accounts activity</i>	<b>Three Months Ended September 30, 2018    2017</b>		<b>Nine Months Ended September 30, 2018    2017</b>	
	<b>(in thousands)</b>			
Beginning balance	\$4,552	\$3,502	\$3,957	\$3,320
Provision (recovery) for doubtful accounts, net	(105 )	769	1,149	1,513
Accounts written-off	(624 )	(310 )	(1,129 )	(1,115 )
Effect of change in exchange rates	(1 )	30	(155 )	273
Ending balance	\$3,822	\$3,991	\$3,822	\$3,991

<i>Inventories</i>	<b>September 30, 2018</b>	<b>December 31, 2017</b>
	<b>(in thousands)</b>	
Materials	\$128,744	\$126,656
Work in process	8,595	9,863
Finished goods	70,699	57,316
Total inventories	\$208,038	\$193,835

<i>Property, plant, and equipment, net</i>	<b>September 30, 2018</b>	<b>December 31, 2017</b>
	<b>(in thousands)</b>	
Machinery and equipment	\$318,218	\$310,753
Computers and software	112,681	104,384
Buildings, furniture, and improvements	149,934	135,566
Land	15,463	18,433
Construction in progress, including purchased equipment	41,423	39,946
Total cost	637,719	609,082
Accumulated depreciation	(416,924 )	(408,314 )
Property, plant, and equipment, net	\$220,795	\$200,768

<i>Depreciation expense</i>	<b>Three Months Ended September 30, 2018    2017</b>		<b>Nine Months Ended September 30, 2018    2017</b>	
	<b>(in thousands)</b>			
Depreciation expense	\$ 12,489	\$ 10,907	\$ 38,729	\$ 30,856

Table of Contents**Note 4: Intangible Assets and Liabilities**

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

	September 30, 2018			December 31, 2017		
	Gross	Accumulated (Amortization) Net Accretion		Gross	Accumulated (Amortization) Net Accretion	
	(in thousands)					
Intangible Assets						
Core-developed technology	\$ 515,949	\$ (427,069 )	\$ 88,880	\$ 429,548	\$ (399,969 )	\$ 29,579
Customer contracts and relationships	385,148	(210,735 )	174,413	258,586	(197,582 )	61,004
Trademarks and trade names	79,739	(69,376 )	10,363	70,056	(66,004 )	4,052
Other	12,602	(11,166 )	1,436	11,661	(11,068 )	593
Total intangible assets subject to amortization	\$ 993,438	\$ (718,346 )	\$ 275,092	\$ 769,851	\$ (674,623 )	\$ 95,228
In-process research and development	3,100	—	3,100	—	—	—
Total intangible assets	\$ 996,538	\$ (718,346 )	\$ 278,192	\$ 769,851	\$ (674,623 )	\$ 95,228
Intangible Liabilities						
Customer contracts and relationships	\$ (23,900 )	\$ 3,913	\$ (19,987 )	\$ —	\$ —	\$ —

A summary of intangible assets and liabilities activity is as follows:

		<b>Nine Months Ended September 30,</b>	
		<b>2018</b>	<b>2017</b>
		<b>(in thousands)</b>	
Beginning balance, intangible assets, gross		\$ 769,851	\$ 669,896
Intangible assets acquired	242,039		36,500
Effect of change in exchange rates	(15,352 )		57,640
Ending balance, intangible assets, gross		\$ 996,538	\$ 764,036
Beginning balance, intangible liabilities, gross		\$ —	\$ —
Intangible liabilities acquired	(23,900 )		—
Effect of change in exchange rates	—		—
Ending balance, intangible liabilities		\$ (23,900 )	\$ —

liabilities,  
gross

On January 5, 2018, we completed our acquisition of Silver Spring Networks, Inc. (SSNI) by purchasing 100% of the voting stock. Intangible assets acquired in 2018 are primarily based on the preliminary purchase price allocation relating to this acquisition. Acquired intangible assets include in-process research and development (IPR&D), which is not amortized until such time as the associated development projects are completed. Of these projects, \$11.3 million were completed during the nine months ended September 30, 2018 and are included in core-developed technology. The remaining IPR&D is expected to be completed in the next year. Acquired intangible liabilities reflect the present value of the projected cash outflows for an existing contract where remaining costs are expected to exceed projected revenues. Refer to Note 17 for additional information regarding this acquisition.

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Estimated future annual amortization (accretion) is as follows:

<b>Year Ending December 31,</b>	<b>Amortization</b>	<b>Accretion</b>	<b>Estimated Annual Amortization, net</b>
	<b>(in thousands)</b>		
2018 (amount remaining at September 30, 2018)	\$19,547	\$(1,304 )	\$ 18,243
2019	72,681	(8,233 )	64,448
2020	52,727	(8,028 )	44,699
2021	37,314	(1,963 )	35,351
2022	27,160	(459 )	26,701
Beyond 2022	65,663	—	65,663
Total intangible assets subject to amortization (accretion)	\$275,092	\$(19,987 )	\$ 255,105

We have recognized \$18.0 million and \$5.6 million of net amortization of intangible assets for the three months ended September 30, 2018 and 2017, respectively, and \$53.7 million and \$15.1 million for the nine months ended September 30, 2018 and 2017, respectively within operating expenses in the Consolidated Statement of Operations. These expenses relate to intangible assets and liabilities acquired as part of a business combination.

**Note 5: Goodwill**

The following table reflects goodwill allocated to each reporting unit:

	<b>Electricity</b>	<b>Gas</b>	<b>Water</b>	<b>Networks</b>	<b>Total Company</b>
	<b>(in thousands)</b>				
Goodwill balance at January 1, 2018					
Goodwill before impairment	\$500,625	\$352,703	\$378,901	\$—	\$1,232,229
Accumulated impairment losses	(386,384 )	—	(290,083 )	—	(676,467 )
Goodwill, net	114,241	352,703	88,818	—	555,762
Goodwill acquired	—	—	—	570,790	570,790
Effect of change in exchange rates	(370 )	(3,259 )	(785 )	(243 )	(4,657 )
Goodwill balance at September 30, 2018					
Goodwill before impairment	496,565	349,444	374,569	570,547	1,791,125
Accumulated impairment losses	(382,694 )	—	(286,536 )	—	(669,230 )
Goodwill, net	\$113,871	\$349,444	\$88,033	\$570,547	\$1,121,895

**Note 6: Debt**

The components of our borrowings were as follows:

	<b>September 30, 2018</b>	<b>December 31, 2017</b>
	<b>(in thousands)</b>	
Credit facility:		
USD denominated term loan	\$641,875	\$ 194,063
Multicurrency revolving line of credit	10,000	125,414
Senior notes	400,000	300,000

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Total debt	1,051,875	619,477
Less: current portion of debt	24,375	19,688
Less: unamortized prepaid debt fees - term loan	5,208	629
Less: unamortized prepaid debt fees - senior notes	16,915	5,588
Long-term debt	\$ 1,005,377	\$ 593,572

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### *Credit Facility*

On January 5, 2018, we entered into a credit agreement providing for committed credit facilities in the amount of \$1.2 billion U.S. dollars (the 2018 credit facility) which amended and restated in its entirety our credit agreement dated June 23, 2015 and replaced committed facilities in the amount of \$725 million. The 2018 credit facility consists of a \$650 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 \$300 million standby letter of credit sub-facility and a \$50 million swingline sub-facility. Both the term loan and the revolver mature on January 5, 2023 and can be repaid without penalty. Amounts repaid on the term loan may not be reborrowed and amounts borrowed under the revolver may be repaid and reborrowed until the revolver's maturity, at which time 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 0.18% to 0.35% per annum depending on our total leverage ratio as of the most recently ended fiscal quarter.

The 2018 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 2018 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 their related assets. This includes 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 first-tier foreign subsidiaries. In addition, the obligations of any foreign subsidiary who is a foreign borrower, as defined by the 2018 credit facility, are guaranteed by the foreign subsidiary and by its direct and indirect foreign parents. The 2018 credit facility includes debt covenants, which contain certain financial thresholds and place certain restrictions on the incurrence of debt, investments, and the issuance of dividends. We were in compliance with the debt covenants under the 2018 credit facility at September 30, 2018.

Under the 2018 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 (subject to a 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 0.50%, or (iii) one-month LIBOR plus 1.00%. At September 30, 2018, the interest rate for both the term loan and revolver was 4.25%, which includes the LIBOR rate plus a margin of 2.00%.

### *Senior Notes*

On December 22, 2017 and January 19, 2018, we issued \$300 million and \$100 million, respectively, of aggregate principal amount of 5.00% senior notes maturing January 15, 2026 (Notes). The proceeds were used to refinance existing indebtedness related to the acquisition of SSNI, pay related fees and expenses, and for general corporate purposes. Interest on the Notes is payable semi-annually in arrears on January 15 and July 15, commencing on July 15, 2018. The Notes are fully and unconditionally guaranteed, jointly and severally, on a senior unsecured basis by each of our subsidiaries that guarantee the senior credit facilities.

Prior to maturity we may redeem some or all of the Notes, together with accrued and unpaid interest, if any, plus a "make-whole" premium. On or after January 15, 2021, we may redeem some or all of the Notes at any time at declining redemption prices equal to 102.50% beginning on January 15, 2021, 101.25% beginning on January 15, 2022 and 100.00% beginning on January 15, 2023 and thereafter to the applicable redemption date. In addition, before January 15, 2021, and subject to certain conditions, we may redeem up to 35% of the aggregate principal amount of Notes with the net proceeds of certain equity offerings at 105.00% of the principal amount thereof to the date of redemption; provided that (i) at least 65% of the aggregate principal amount of Notes remains outstanding after such



redemption and (ii) the redemption occurs within 60 days of the closing of any such equity offering.

*Debt Maturities*

The amount of required minimum principal payments on our long-term debt in aggregate over the next five years, are as follows:

<b>Year Ending December 31,</b>	<b>Minimum Payments (in thousands)</b>
2018 (amount remaining at September 30, 2018)	\$ 4,063
2019	28,438
2020	44,777
2021	60,937
2022	65,000
2023	448,660
Total minimum payments on debt	\$ 651,875

Table of Contents**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	
		September 30, 2018	December 31, 2017
Derivative Assets	Balance Sheet Location		
Derivatives designated as hedging instruments under Subtopic 815-20		(in thousands)	
Interest rate swap contract	Other current assets	\$2,051	\$ 658
Interest rate cap contracts	Other current assets	607	17
Cross currency swap contract	Other current assets	1,711	—
Interest rate swap contract	Other long-term assets	1,733	1,712
Interest rate cap contracts	Other long-term assets	728	179
Cross currency swap contract	Other long-term assets	738	—
Derivatives not designated as hedging instruments under Subtopic 815-20			
Foreign exchange forward contracts	Other current assets	69	41
Interest rate cap contracts	Other current assets	—	25
Interest rate cap contracts	Other long-term assets	—	268
Total asset derivatives		\$7,637	\$ 2,900

**Derivative Liabilities****Derivatives not designated as hedging instruments under Subtopic 815-20**

Foreign exchange forward contracts	Other current liabilities	\$240	\$ 289
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The changes in accumulated other comprehensive income (loss) (AOCI), net of tax, for our derivative and nonderivative hedging instruments, were as follows:

	2018	2017
	(in thousands)	
Net unrealized gain (loss) on hedging instruments at January 1,	\$ (13,414 )	\$ (14,337 )
Unrealized gain (loss) on hedging instruments	4,770	(295 )
Realized loss (gain) reclassified into net income	(2,207 )	482
Net unrealized gain (loss) on hedging instruments at September 30,	\$ (10,851 )	\$ (14,150 )

Reclassification of amounts related to hedging instruments are included in interest expense in the Consolidated Statements of Operations for the periods ended September 30, 2018 and 2017. Included in the net unrealized gain (loss) on hedging instruments at September 30, 2018 and 2017 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:

<i>Offsetting of Derivative Assets</i>	<b>Gross Amounts Not Offset in the Consolidated Balance Sheet</b>	<b>Gross Amounts Not Offset in the Consolidated Balance Sheet</b>	<b>Cash Collateral Received</b>	<b>Net Amount</b>
	<b>Assets Presented in the Consolidated Balance Sheet</b>	<b>Derivative Financial Instruments</b>	<b>Cash Collateral Received</b>	<b>Net Amount</b>
	<b>(in thousands)</b>			
September 30, 2018	\$7,637	\$ (102 )	\$	—\$ 7,535
December 31, 2017	\$2,900	\$ (90 )	\$	—\$ 2,810

<i>Offsetting of Derivative Liabilities</i>	<b>Gross Amounts Not Offset in the Consolidated Balance Sheet</b>	<b>Gross Amounts Not Offset in the Consolidated Balance Sheet</b>	<b>Cash Collateral Pledged</b>	<b>Net Amount</b>
	<b>Liabilities Presented in the Consolidated Balance Sheet</b>	<b>Derivative Financial Instruments</b>	<b>Cash Collateral Pledged</b>	<b>Net Amount</b>
	<b>(in thousands)</b>			
September 30, 2018	\$240	\$ (102 )	\$	—\$ 138
December 31, 2017	\$289	\$ (90 )	\$	—\$ 199

Our derivative assets and liabilities subject to netting arrangements consist of foreign exchange forward and interest rate contracts with five counterparties at September 30, 2018 and three counterparties at December 31, 2017. No derivative asset or liability balance with any of our counterparties was individually significant at September 30, 2018 or December 31, 2017. 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 interest rate caps and swaps to reduce the variability of cash flows from increases in the LIBOR based borrowing rates on our floating rate credit facility. These instruments do not protect us from changes to the applicable margin under our credit facility. At September 30, 2018, our LIBOR-based debt balance was \$652.0 million.

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. Changes in the fair value of the interest rate swap are recognized as a component of other comprehensive income (OCI) and are recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as an adjustment to interest expense along with the earnings effect of the hedged item. The amount of net gains expected to be reclassified into earnings in the next 12 months is \$2.1 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. As of December 31, 2016, due to the accelerated revolver payments from surplus cash, we elected to de-designate two of the interest rate cap contracts as cash flow hedges and discontinued the use of cash flow hedge accounting. The amounts recognized in AOCI from de-designated interest rate cap contracts were maintained in AOCI as the forecasted transactions were still probable to occur, and subsequent changes in fair value were recognized within interest expense. In April 2018, due to increases in our total LIBOR-based debt, we elected to re-designate the two interest rate cap contracts as cash flow hedges. Future changes in the fair value of these instruments will be recognized as a component of OCI, and these changes together with amounts previously maintained in AOCI will be recognized in earnings when the hedged item affects earnings. The amounts paid or received on the hedge are recognized as an adjustment to interest expense along with the earnings effect of the hedged item. The amount of net losses expected to be reclassified into earnings for all interest rate cap contracts in the next 12 months is \$0.1 million.

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In April 2018, we entered into a cross-currency swap which converts \$56.0 million of floating LIBOR-based U.S. Dollar denominated debt into 1.38% fixed rate euro denominated debt. This cross-currency swap matures on April 30, 2021 and mitigates the risk associated with fluctuations in currency rates impacting cash flows related to U.S. Dollar denominated debt in a euro functional currency entity. Changes in the fair value of the cross-currency swap are recognized 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 are recognized as an adjustment to interest expense along with the earnings effect of the hedged item. The amount of net gains expected to be reclassified into earnings in the next 12 months is \$1.7 million.

The before-tax effects of our accounting for derivative instruments designated as hedges on AOCI were as follows:

Derivatives in Subtopic 815-20 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative		Gain (Loss) Reclassified from AOCI into Income		
			Location	Amount	
	2018	2017		2018	2017
	(in thousands)				(in thousands)
Three Months Ended September 30,					
Interest rate swap contract	\$ 302	\$ 81	Interest expense	\$ 314	\$(92 )
Interest rate cap contracts	(220 )	(24 )	Interest expense	(149 )	(55 )
Cross currency swap contract	599	—	Interest expense	363	—
Cross currency swap contract	—	—	Other income/(expense), net	(733 )	—
Nine Months Ended September 30,					
Interest rate swap contract	\$ 2,062	\$ (255			