

BADGER METER INC  
Form 10-Q  
August 02, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of**  
**the Securities Exchange Act of 1934**

for the quarterly period ended June 30, 2012

**BADGER METER, INC.**

4545 W. Brown Deer Road

Milwaukee, Wisconsin 53223

(414) 355-0400

A Wisconsin Corporation

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IRS Employer Identification No. 39-0143280

Commission File No. 001-06706

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (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

As of July 13, 2012, there were 14,290,872 shares of Common stock outstanding with a par value of \$1 per share.

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### **Special Note Regarding Forward Looking Statements**

Certain statements contained in this Quarterly Report on Form 10-Q, as well as other information provided from time to time by Badger Meter, Inc. (the Company) or its employees, may contain forward looking statements that involve risks and uncertainties that could cause actual results to differ materially from those in the forward looking statements. The words anticipate, believe, estimate, expect, think, should, could, objective or similar expressions are intended to identify forward looking statements. All such forward looking statements are based on the Company's then current views and assumptions and involve risks and uncertainties. Some risks and uncertainties that could cause actual results to differ materially from those expressed or implied in forward looking statements include those described in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2011 that include, among other things:

the continued shift in the Company's business from lower cost, manually read meters toward more expensive, value-added automatic meter reading (AMR) systems, advanced metering infrastructure (AMI) systems and advanced metering analytics (AMA) systems that offer more comprehensive solutions to customers' metering needs;

the success or failure of newer Company products;

changes in competitive pricing and bids in both the domestic and foreign marketplaces, and particularly in continued intense price competition on government bid contracts for lower cost, manually read meters;

the actions (or lack thereof) of the Company's competitors;

changes in the Company's relationships with its alliance partners, primarily its alliance partners that provide AMR/AMI connectivity solutions, and particularly those that sell products that do or may compete with the Company's products;

changes in the general health of the United States and foreign economies, including to some extent such things as the length and severity of global economic downturns, the ability of municipal water utility customers to authorize and finance purchases of the Company's products, the Company's ability to obtain financing, housing starts in the United States, and overall industrial activity;

the timing and impact of government programs to stimulate national and global economies;

changes in the cost and/or availability of needed raw materials and parts, such as volatility in the cost of brass castings as a result of fluctuations in commodity prices, particularly for copper and scrap metal at the supplier level, foreign-sourced electronic components as a result of currency exchange fluctuations and/or lead times, and plastic resin as a result of changes in petroleum and natural gas prices;

the Company's expanded role as a prime contractor for providing complete AMR/AMI/AMA systems to governmental entities, which brings with it added risks, including but not limited to, the Company's responsibility for subcontractor performance, additional costs and expenses if the Company and its subcontractors fail to meet the timetable agreed to with the governmental entity, and the Company's expanded warranty and performance obligations;

the Company's ability to successfully integrate acquired businesses or products;

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changes in foreign economic conditions, particularly currency fluctuations in the United States dollar, the Euro and the Mexican peso;

the loss of certain single-source suppliers; and

changes in laws and regulations, particularly laws dealing with the use of lead (which can be used in the manufacture of certain meters incorporating brass housings) and the United States Federal Communications Commission rules affecting the use and/or licensing of radio frequencies necessary for AMR/AMI/AMA products.

All of these factors are beyond the Company's control to varying degrees. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward looking statements contained in this Quarterly Report on Form 10-Q and are cautioned not to place undue reliance on such forward looking statements. The forward looking statements made in this document are made only as of the date of this document and the Company assumes no obligation, and disclaims any obligation, to update any such forward looking statements to reflect subsequent events or circumstances.

**Table of Contents****Part I Financial Information****Item 1 Financial Statements****BADGER METER, INC.****Consolidated Condensed Balance Sheets**

|  | June 30,<br>2012<br>(Unaudited) | December 31,<br>2011 |
|--|---------------------------------|----------------------|
|  | (In thousands)                  |                      |
| <b>Assets</b>  |                                 |                      |
| Current assets:  |                                 |                      |
| Cash   | \$ 6,511                        | \$ 4,975             |
| Receivables  | 51,670                          | 41,168               |
| Inventories:   |                                 |                      |
| Finished goods   | 12,985                          | 13,476               |
| Work in process  | 13,639                          | 11,377               |
| Raw materials  | 34,455                          | 24,583               |
| Total inventories  | 61,079                          | 49,436               |
| Prepaid expenses and other current assets                | 3,431                           | 2,266                |
| Deferred income taxes                                    | 3,960                           | 3,350                |
| Total current assets                                     | 126,651                         | 101,195              |
| Property, plant and equipment, at cost                   | 150,530                         | 144,928              |
| Less accumulated depreciation                            | (82,339)                        | (78,826)             |
| Net property, plant and equipment                        | 68,191                          | 66,102               |
| Intangible assets, at cost less accumulated amortization | 61,169                          | 33,680               |
| Other assets   | 6,262                           | 6,259                |
| Deferred income taxes                                    |                                 | 2,309                |
| Goodwill   | 35,670                          | 9,365                |
| Total assets   | \$ 297,943                      | \$ 218,910           |
| <b>Liabilities and shareholders equity</b>               |                                 |                      |
| Current liabilities:                                     |                                 |                      |
| Short-term debt  | \$ 77,828                       | \$ 1,790             |
| Payables   | 18,859                          | 11,365               |
| Accrued compensation and employee benefits               | 7,768                           | 6,734                |
| Warranty and after-sale costs                            | 1,152                           | 1,593                |
| Income and other taxes                                   | 1,498                           | 931                  |
| Total current liabilities                                | 107,105                         | 22,413               |
| Other long-term liabilities                              | 5,592                           | 1,078                |
| Deferred income taxes                                    | 10,230                          |                      |
| Accrued non-pension postretirement benefits              | 6,104                           | 6,103                |
| Other accrued employee benefits                          | 9,153                           | 10,035               |
| Commitments and contingencies (Note 6)                   |                                 |                      |
| Shareholders equity:                                     |                                 |                      |

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|  |                |                |
|--|----------------|----------------|
| Common stock                               | 20,419         | 21,292         |
| Capital in excess of par value             | 40,402         | 39,445         |
| Reinvested earnings                        | 146,183        | 166,271        |
| Accumulated other comprehensive loss       | (14,511)       | (14,566)       |
| Less: Employee benefit stock               | (1,262)        | (1,485)        |
| Treasury stock, at cost                    | (31,472)       | (31,676)       |
| <b>Total shareholders' equity</b>          | <b>159,759</b> | <b>179,281</b> |
| <br>                                       |                |                |
| Total liabilities and shareholders' equity | \$ 297,943     | \$ 218,910     |

*See accompanying notes to consolidated condensed financial statements.*

**Table of Contents****BADGER METER, INC.****Consolidated Condensed Statements of Operations**

|   | Three Months Ended                                |            | Six Months Ended |            |
|---|---|------------|------------------|------------|
|   | June 30,  |            | June 30,         |            |
|   | (Unaudited)                                       |            | (Unaudited)      |            |
|   | (In thousands except share and per share amounts) |            |                  |            |
|   | 2012  | 2011       | 2012             | 2011       |
| Net sales   | \$ 81,974   | \$ 75,148  | \$ 158,207       | \$ 132,507 |
| Cost of sales                                     | 51,773  | 47,928     | 99,142           | 84,850     |
| Gross margin                                      | 30,201  | 27,220     | 59,065           | 47,657     |
| Selling, engineering and administration           | 18,846  | 14,943     | 37,522           | 30,142     |
| Operating earnings                                | 11,355  | 12,277     | 21,543           | 17,515     |
| Interest expense                                  | 238   | 96         | 443              | 208        |
| Earnings before income taxes                      | 11,117  | 12,181     | 21,100           | 17,307     |
| Provision for income taxes                        | 3,675   | 4,347      | 7,409            | 6,213      |
| Net earnings                                      | \$ 7,442  | \$ 7,834   | \$ 13,691        | \$ 11,094  |
| Per share amounts:                                |   |            |                  |            |
| Earnings per share:                               |   |            |                  |            |
| Basic   | \$ 0.52   | \$ 0.52    | \$ 0.94          | \$ 0.74    |
| Diluted   | \$ 0.52   | \$ 0.52    | \$ 0.94          | \$ 0.74    |
| Dividends declared Common stock                   | \$ 0.16   | \$ 0.14    | \$ 0.32          | \$ 0.28    |
| Shares used in computation of earnings per share: |   |            |                  |            |
| Basic   | 14,234,900  | 14,962,314 | 14,527,328       | 14,943,502 |
| Impact of dilutive securities                     | 72,332  | 90,478     | 68,785           | 91,955     |
| Diluted   | 14,307,232  | 15,052,792 | 14,596,113       | 15,035,457 |

*See accompanying notes to consolidated condensed financial statements.*



**Table of Contents****BADGER METER, INC.****Consolidated Condensed Statements of Comprehensive Income**

|   | Three Months Ended<br>June 30,<br>(Unaudited) |          | Six Months Ended<br>June 30,<br>(Unaudited) |           |
|---|---|----------|---|-----------|
|   | 2012  | 2011     | 2012  | 2011      |
|   | (In thousands)                                |          |   |           |
| Net earnings  | \$ 7,442                                      | \$ 7,834 | \$ 13,691                                   | \$ 11,094 |
| Other comprehensive income:                           |   |          |   |           |
| Foreign currency translation adjustment               | (774)   | 474      | (224)                                       | 1,047     |
| Employee benefit funded status adjustment, net of tax | (73)  | 344      | 279   | 710       |
| Comprehensive income                                  | \$ 6,595                                      | \$ 8,652 | \$ 13,746                                   | \$ 12,851 |

*See accompanying notes to consolidated condensed financial statements.*

**Table of Contents****BADGER METER, INC.****Consolidated Condensed Statements of Cash Flows**

|  | Six Months Ended<br>June 30,<br>(Unaudited)<br>(In thousands) |           |
|--|---|-----------|
|  | 2012  | 2011      |
| <b>Operating activities:</b>   |   |           |
| Net earnings   | \$ 13,691   | \$ 11,094 |
| Adjustments to reconcile net earnings to net cash provided by (used for) operations: |   |           |
| Depreciation   | 3,923   | 3,793     |
| Amortization   | 1,992   | 1,172     |
| Deferred income taxes  | 112   | (15)      |
| Noncurrent employee benefits   | 482   | 1,812     |
| Stock-based compensation expense   | 576   | 542       |
| Changes in:  |   |           |
| Receivables  | (5,483)   | (4,739)   |
| Inventories  | (4,995)   | 1,693     |
| Prepaid expenses and other current assets  | (16)  | (1,289)   |
| Liabilities other than debt  | 3,794   | 3,752     |
| Total adjustments  | 385   | 6,721     |
| Net cash provided by operations  | 14,076  | 17,815    |
| <b>Investing activities:</b>   |   |           |
| Property, plant and equipment expenditures   | (2,413)   | (2,366)   |
| Acquisitions, net of cash acquired and future payments                               | (51,517)  | (3,954)   |
| Net cash used for investing activities   | (53,930)  | (6,320)   |
| <b>Financing activities:</b>   |   |           |
| Net increase in short-term debt  | 76,339  | (7,181)   |
| Dividends paid   | (4,676)   | (4,207)   |
| Proceeds from exercise of stock options  | 209   | 234       |
| Tax benefit on stock options   | 115   | 141       |
| Repurchase of Common stock   | (30,000)  |           |
| Issuance of treasury stock   | 391   | 417       |
| Net cash provided by (used for) financing activities                                 | 42,378  | (10,596)  |
| Effect of foreign exchange rates on cash   | (988)   | 285       |
| Increase in cash   | 1,536   | 1,184     |
| Cash beginning of period   | 4,975   | 3,089     |
| Cash end of period   | \$ 6,511  | \$ 4,273  |

*See accompanying notes to consolidated condensed financial statements.*



**Table of Contents****BADGER METER, INC.****Notes to Unaudited Consolidated Condensed Financial Statements****Note 1 Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated condensed financial statements of Badger Meter, Inc. (the Company) contain all adjustments (consisting only of normal recurring accruals except as otherwise discussed) necessary to present fairly the Company's consolidated condensed financial position at June 30, 2012, results of operations for the three- and six-month periods ended June 30, 2012 and 2011, comprehensive income for the three- and six-month periods ended June 30, 2012 and 2011, and cash flows for the six-month periods ended June 30, 2012 and 2011. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

**Note 2 Additional Financial Information Disclosures**

The consolidated condensed balance sheet at December 31, 2011 was derived from amounts included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Refer to the footnotes to the financial statements included in that report for a description of the Company's accounting policies and for additional details of the Company's financial condition. The details in those notes have not changed except as discussed below and as a result of normal adjustments in the interim.

**Warranty and After-Sale Costs**

The Company estimates and records provisions for warranties and other after-sale costs in the period in which the sale is recorded, based on a lag factor and historical warranty claim experience. After-sale costs represent a variety of activities outside of the written warranty policy, such as investigation of unanticipated problems after the customer has installed the product, or problems caused by water quality issues. Changes in the Company's warranty and after-sale costs reserve for the three- and six-month periods ended June 30, 2012 and 2011 were as follows:

| (In thousands)                    | Three months ended<br>June 30, |        | Six months ended<br>June 30, |        |
|-----------------------------------|--------------------------------|--------|------------------------------|--------|
|                                   | 2012                           | 2011   | 2012                         | 2011   |
| Balance at beginning of period    | \$ 1,406                       | \$ 911 | \$ 1,593                     | \$ 889 |
| Net additions charged to earnings | 166                            | 272    | 345                          | 476    |
| Costs incurred and adjustments    | (420)                          | (251)  | (786)                        | (433)  |
| Balance at end of period          | \$ 1,152                       | \$ 932 | \$ 1,152                     | \$ 932 |

**Note 3 Employee Benefit Plans**

The Company maintains a non-contributory defined benefit pension plan (sometimes referred to as the qualified pension plan) for certain employees who were employed at December 31, 2011. On December 31, 2010, the Company froze the qualified pension plan for its non-union participants and formed a new defined contribution feature within the Badger Meter Employee Savings and Stock Ownership Plan (ESSOP) in which each employee received a similar benefit. On December 31, 2011, the Company froze the qualified pension plan for its union participants and included them in the defined contribution feature within the ESSOP. After December 31, 2011, employees will not receive any new benefits under the qualified pension plan as benefits have been frozen and the employees now participate in the defined contribution feature of the ESSOP instead. Employees will continue to earn returns on their frozen balances under the qualified pension plan. The Company also maintains a non-contributory postretirement plan that provides medical benefits for certain of its retirees and eligible dependents in the United States.



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The following table sets forth the components of net periodic benefit cost for the three months ended June 30, 2012 and 2011 based on December 31, 2011 and 2010 actuarial measurement dates, respectively:

| (In thousands)                                 | Defined pension plan benefits |        | Other postretirement benefits |        |
|--|-------------------------------|--------|-------------------------------|--------|
|  | 2012                          | 2011   | 2012                          | 2011   |
| Service cost benefits earned during the year   | \$ 12                         | \$ 143 | \$ 39                         | \$ 37  |
| Interest cost on projected benefit obligations | 571                           | 627    | 76                            | 81     |
| Expected return on plan assets                 | (803)                         | (945)  |                               |        |
| Amortization of prior service cost             |                               | 49     | 40                            | 40     |
| Amortization of net (gain) loss                | (154)                         | 449    |                               |        |
| Net periodic benefit cost                      | \$ (374)                      | \$ 323 | \$ 155                        | \$ 158 |

The following table sets forth the components of net periodic benefit cost for the six months ended June 30, 2012 and 2011 based on December 31, 2011 and 2010 actuarial measurement dates, respectively:

| (In thousands)                                 | Defined pension plan benefits |         | Other postretirement benefits |        |
|--|-------------------------------|---------|-------------------------------|--------|
|  | 2012                          | 2011    | 2012                          | 2011   |
| Service cost benefits earned during the year   | \$ 24                         | \$ 286  | \$ 78                         | \$ 74  |
| Interest cost on projected benefit obligations | 1,128                         | 1,254   | 152                           | 162    |
| Expected return on plan assets                 | (1,595)                       | (1,889) |                               |        |
| Amortization of prior service cost             |                               | 98      | 80                            | 80     |
| Amortization of net loss                       | 368                           | 898     |                               |        |
| Net periodic benefit cost                      | \$ (75)                       | \$ 647  | \$ 310                        | \$ 316 |

The Company disclosed in its financial statements for the year ended December 31, 2011 that it estimated it would make a contribution in 2012 of \$1.9 million due to the reduction in the market value of the underlying investments as of the December 31, 2011 actuarial measurement date. At June 30, 2012, the Company believes this amount is a reasonable estimate; however, the estimate remains subject to further calculations prior to the actual payment and may be adjusted.

The Company also disclosed in its financial statements for the year ended December 31, 2011 that it estimated it would pay \$0.5 million in other postretirement benefits in 2012 based on actuarial estimates. As of June 30, 2012, \$0.2 million of such benefits have been paid. The Company continues to believe that its estimated payments for the full year are reasonable. However, such estimates contain inherent uncertainties because cash payments can vary significantly depending on the timing of postretirement medical claims and the collection of the retirees portion of certain costs. Note that the amount of benefits paid in calendar year 2012 will not impact the expense for postretirement benefits for 2012.

**Note 4 Accumulated Comprehensive Income (Loss)**

Components of accumulated other comprehensive loss are as follows:

| (In thousands)   | June 30, 2012 | December 31, 2011 |
|--|---------------|-------------------|
| Cumulative foreign currency translation adjustment                           | \$ 967        | \$ 1,191          |
| Unrecognized pension and postretirement benefit plan liabilities, net of tax | (15,478)      | (15,757)          |

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|                                      |             |             |
|--------------------------------------|-------------|-------------|
| Accumulated other comprehensive loss | \$ (14,511) | \$ (14,566) |
|--------------------------------------|-------------|-------------|

**Note 5 Acquisitions**

On January 31, 2012, the Company completed its acquisition of 100% of the outstanding common stock of Racine Federated, Inc. ( Racine Federated ) of Racine, Wisconsin and its subsidiary Premier Control

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Technologies, Ltd. located in Thetford, England for approximately \$57.3 million in cash, plus an estimated working capital adjustment of \$0.3 million. \$4.6 million of the purchase price is due on July 31, 2013 and is included in other long-term liabilities on the consolidated balance sheet. Racine Federated manufactures and markets flow meters for the water industry as well as various industrial metering and specialty products. These products complement and expand the Company's existing lines for the global flow measurement business.

The acquisition was accounted for under the purchase method, and accordingly, the results of operations are included in the Company's financial statements from the date of acquisition.

On May 23, 2012, the Company signed a new credit agreement which increased its principal line of credit (increasing it from \$90.0 million to \$125.0 million) for a three year period. The line will be permanently reduced by \$16.7 million annually. The line was increased to meet short-term cash needs, if any, that may arise as the result of funding the acquisition of Racine Federated with cash, as well as any cash needs resulting from a \$30.0 million stock repurchase program that began in the first quarter of 2012 and ended in the second quarter of 2012. The issuance of commercial paper may comprise a maximum of \$70.0 million of the line of credit. This facility is unsecured, but there are a number of covenants in effect for the period to which the Company is in compliance.

The Company has not finalized the allocation of the purchase price as of June 30, 2012 because it has not completed its analysis of the fair value of inventories, property, plant and equipment, intangible assets, income tax liabilities and certain contingent liabilities. The following table summarizes the preliminary estimates of fair value of the assets acquired and the liabilities assumed as of the acquisition date:

| (In thousands)                             | January 31,<br>2012 |
|--|---------------------|
| <b>Assets Acquired:</b>                    |                     |
| Cash                                       | \$ 1,529            |
| Receivables                                | 5,002               |
| Inventories                                | 7,602               |
| Prepaid expenses and other current assets  | 172                 |
| Current deferred income taxes              | 466                 |
| Property, plant and equipment              | 3,774               |
| Intangible assets                          | 29,500              |
| Goodwill                                   | 26,305              |
| <br>Total assets acquired                  | <br>\$ 74,350       |
| <b>Liabilities Assumed:</b>                |                     |
| Payables                                   | \$ 3,430            |
| Accrued compensation and employee benefits | 569                 |
| Income taxes                               | 31                  |
| Long-term deferred income taxes            | 12,273              |
| Other long-term liabilities                | 451                 |
| <br>Total liabilities assumed              | <br>\$ 16,754       |

The intangible assets acquired are primarily customer relationships and developed technology, with an estimated average useful life of 15 years.

The following preliminary, unaudited pro forma information combines historical results as if Racine Federated had been owned by the Company for the periods presented.

| (In thousands except per share amounts) | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|---|--------------------------------|-----------|------------------------------|------------|
|   | 2012                           | 2011      | 2012                         | 2011       |
| Net sales                               | \$ 81,974                      | \$ 85,501 | \$ 162,063                   | \$ 153,957 |
| Net earnings                            | \$ 7,442                       | \$ 8,084  | \$ 14,130                    | \$ 12,404  |



|                            |         |         |         |         |
|----------------------------|---------|---------|---------|---------|
| Diluted earnings per share | \$ 0.52 | \$ 0.54 | \$ 0.97 | \$ 0.82 |
|----------------------------|---------|---------|---------|---------|

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The pro forma results include amortization of the intangibles mentioned above, interest expense on debt incurred to finance the acquisition, the elimination of certain acquisition costs and the income tax effect on the pro forma adjustments. The pro forma results are not necessarily indicative of what would have occurred if the acquisition had been completed as of the beginning of each fiscal period presented, nor are they necessarily indicative of future consolidated results.

On January 26, 2011, the Company purchased Remag, AG ( Remag ) of Bern, Switzerland for \$4.9 million. Remag distributes a line of precision flow measurement products, some of which they manufacture, for the global industrial market. Their small turbine meters complement and expand the Company's existing line of industrial flow products. The Company's purchase price allocation included \$0.9 million of cash, plus approximately \$0.4 million of receivables, \$0.4 million of inventory, \$2.0 million of property, plant and equipment, \$1.8 million of intangibles, \$0.2 million of goodwill, and \$0.1 million of net other assets and liabilities.

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

### **Note 6 Contingencies, Litigation and Commitments**

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

The Company is subject to contingencies related to environmental laws and regulations. The Company is named as one of many potentially responsible parties in two landfill lawsuits. The landfill sites are impacted by the Federal Comprehensive Environmental Response, Compensation and Liability Act and other environmental laws and regulations. At this time, the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. This belief is based on the Company's assessment of its limited past involvement with these landfill sites as well as the substantial involvement of and government focus on other named third parties with these landfill sites. However, due to the inherent uncertainties of such proceedings, the Company cannot predict the ultimate outcome of any of these matters. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2011 and the first half of 2012 were not material.

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

The Company has been named as a defendant in two pending patent infringement lawsuits. One of these lawsuits alleges the Company and other parties infringed a patent on a metering data feature. The other lawsuit alleges the Company and other parties infringed an automotive lubrication product patent. As part of its sales contracts, the Company indemnifies customers for intellectual property infringement claims on its products and pays for certain costs, damages and fees if applicable conditions are met. The complaints seek unspecified damages as well as injunctive relief. The Company believes these claims are without merit and it is vigorously defending its interests. Although it is not possible to predict the ultimate outcome of these matters, the Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole.

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

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

### **Note 7 Income Taxes**

The provision for income taxes as a percentage of earnings before income taxes for the second quarter of 2012 was 33.1% compared to 35.7% in the second quarter of 2011, due to the recognition in tax expense in 2012 of favorable state income tax audit outcomes for prior periods. The provision for income taxes as a percentage of earnings before income taxes for the first half of 2012 was 35.1% compared to 35.9% in the first half of 2011.

### **Note 8 Fair Value Measurements of Financial Instruments**

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

### **Note 9 Subsequent Events**

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

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

### **Business Description and Overview**

The core competency of the Company is flow measurement solutions. The Company is a leading innovator, manufacturer and marketer of flow measurement and control products, serving water and gas utilities, municipalities and industrial customers worldwide. Measuring a wide variety of liquids ranging from water and oil to lubricants in industrial processes, the Company's products are known for their high degree of accuracy, long-lasting durability and ability to provide valuable and timely measurement information to customers. The Company's product lines fall into three categories: sales of meters and related technologies to municipal water utilities (municipal water), sales of meters to various industries for water and other fluids (industrial flow) and sales of valves, concrete vibrators and gas meter radios to unique markets (specialty products). While the discussion of sales focuses on these three categories due to the different markets served, the Company estimates that over 75% of its products are used in water applications when all categories are grouped together.

Municipal water, the largest category by sales volume, includes water meters and related technologies and services used by water utilities as the basis for generating water and wastewater revenues. The key market for the Company's water meter products is North America, primarily the United States, because the meters are designed and manufactured to conform to standards promulgated by the American Water Works Association. Sales of water meters and related technologies and services are commonly referred to as residential or commercial water meter sales, the latter referring to larger sizes of meters.

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Industrial flow includes products sold for other water-based purposes, including irrigation, water reclamation and industrial process applications as well as meters and related technologies and services for measuring a wide variety of fluids in industries such as food and beverage, pharmaceutical production, petroleum, heating, ventilating and air conditioning (HVAC), and measuring and dispensing automotive fluids.

Specialty products include sales of radio technology to natural gas utilities for installation on their gas meters, as well as valves and concrete vibrators.

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

Fixed network advanced metering infrastructure (AMI) systems continue to build interest among water utilities. These systems incorporate a network of permanent data collectors or gateway receivers that are always active or listening for the radio transmission from the utility's meters. AMI systems eliminate the need for utility personnel to drive through service territories to collect meter reading data. These systems provide the utilities with more frequent and diverse data from the utility's meters at specified intervals.

In 2011, the Company introduced what it believes will be the next generation of metering technology, advanced metering analytics (AMA), along with a host of automated utility management tools to facilitate the ability of water utilities to increase their productivity and revenue, as well as proactively utilize their data. AMA is comprised of ReadCenter® Analytics software coupled with the new ORION® SE two-way fixed network technology, which is complemented by a family of highly accurate and reliable water meters. The ORION SE system can operate as a mobile AMR system, a fixed network AMI system, or both. For example, a water or gas utility can begin deployment in mobile mode and migrate to a fixed network system. Also, if the system is operating in fixed network mode and the collector network goes down, the system will automatically revert to mobile mode, allowing the utility to continue collecting readings. Once the collector network is back up, it will automatically revert back to its fixed network mode. By using AMA, utilities will be able to proactively manage their day-to-day operations through powerful analytics-based software and two-way fixed network meter reading.

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

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

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

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Industrial flow and specialty products serve niche flow measurement and control applications across a broad industrial spectrum. Specialized communication protocols that control the entire flow measurement process drive these markets. The Company's specific flow measurement and control applications and technologies serve the flow measurement market through both customized and standard precision flow measurement technologies.

### **Business Trends**

Increasingly, the electric utility industry relies on AMI technology for two-way communication to monitor and control electrical devices at the customer's site. Although the Company does not sell products for electric market applications, the trend toward AMI affects the markets in which the Company does participate, particularly for those customers in the water utility market that are interested in more frequent and diverse data collection. Specifically, AMI and AMA technologies enable water utilities to capture readings from each meter at specific intervals.

The Company sells its technology solutions to meet customer requirements. Since the technology products have comparable margins, any change in the mix between AMR, AMI or AMA is not expected to have a significant impact on the Company's net sales related to meter reading technology.

There are approximately 53,000 water utilities in the United States and the Company estimates that less than 30 percent of them have converted to an AMR or AMI technology. Although there is growing interest in AMI and AMA communication by water utilities, the vast majority of utilities installing such technology continue to select AMR technologies for their applications. The Company's ORION technology has experienced rapid acceptance in the United States as an increasing number of water utilities have selected ORION as their AMR solution. The Company anticipates that even with growing interest in AMI and AMA, AMR will continue to be the primary product of choice for a number of years. For many water utilities, AMR technology is simply the most cost-effective solution available today. However, with the introduction of AMA, the Company believes it is well-positioned to meet customers' future needs.

### **Acquisition**

On January 31, 2012, the Company completed its acquisition of 100% of the outstanding common stock of Racine Federated, Inc. of Racine, Wisconsin and its subsidiary Premier Control Technologies, Ltd. located in Thetford, England for approximately \$57.3 million in cash, plus an estimated working capital adjustment of \$0.3 million. Racine Federated manufactures and markets flow meters for the water industry as well as various industrial metering and specialty products. These products complement and expand the Company's existing lines for the global flow measurement business. This acquisition is further described in Note 5 Acquisitions in the accompanying Notes to Unaudited Consolidated Condensed Financial Statements.

On January 26, 2011, the Company purchased Remag, AG of Bern, Switzerland for \$4.9 million. Remag distributes a line of precision flow measurement products, some of which they manufacture, for the global industrial market. Their small turbine meters complement and expand the Company's existing line of industrial flow products. This acquisition is further described in Note 5 Acquisitions in the accompanying Notes to Unaudited Consolidated Condensed Financial Statements.

### **Revenue and Product Mix**

Prior to the Company's introduction of its own proprietary AMR products (ORION), Itron water utility-related products were a dominant AMR contributor to the Company's results. Itron products are sold under an agreement between the Company and Itron, Inc. that has been renewed multiple times and is in effect until early 2016. The Company's ORION products directly compete with Itron water AMR products. In recent years, many of the Company's customers have selected ORION products over Itron products. While ORION sales were 2.4 times greater than those of the Itron licensed products for the first six months of 2012 and 2.7 times greater for all of 2011, the Company expects that the Itron products will remain a significant component of sales to water utilities. Continuing sales in both product lines underscores the continued acceptance of AMR technology by water utilities and affirms the Company's strategy of selling Itron products in addition to its own proprietary products.

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As the industry continues to evolve, the Company has been vigilant in anticipating and exceeding customer expectations. In 2011, the Company introduced AMA as a hardware and software solution for water and gas utilities, which it believes will help maintain the Company's position as a market leader. The Company continues to seek opportunities for additional revenue enhancement. For instance, the Company is periodically asked to oversee and perform field installation of its products for certain customers. The Company assumes the role of general contractor, hiring installation subcontractors and supervising their work. The Company also supports its product and technology sales with the sale of extended service programs that provide additional services beyond the standard warranty. In recent years, the Company has sold ORION radio technology to natural gas utilities for installation on their gas meters. The revenues from such products and services are not yet significant and the Company is uncertain of the potential growth achievable for such products and services in future periods.

**Results of Operations Three Months Ended June 30, 2012**

The Company's net sales for the three months ended June 30, 2012 increased \$6.9 million, or 9.2%, to \$82.0 million compared to \$75.1 million during the same period in 2011. The increase was due to the inclusion of Racine Federated's sales in the second quarter of 2012 as a result of the acquisition on January 31, 2012, offset by a slight decline in municipal sales and a decrease in sales of radios for natural gas meters. Racine Federated's sales for the three months ended June 30, 2012 were \$11.9 million.

Municipal water sales decreased \$1.4 million, or 2.6%, from \$54.4 million in the second quarter of 2011 to \$53.0 million in the second quarter of 2012. These sales represented 64.6% of sales for the three months ended June 30, 2012. The decrease was principally due to lower sales of residential meters sold with technology, partially offset by higher commercial meter sales. Sales of the Company's ORION AMR technology related products decreased 25.9% due to lower volumes of product sold. Sales of the Itron related products decreased 3.3%. In the most recent period, ORION related products outsold Itron related products by a ratio of 1.8 to 1. Manually read residential meter sales increased slightly due to higher volumes sold. Commercial meter sales increased 24.9% in this period over the same period in 2011 due to higher volumes of products sold. Sales of Galaxy fixed network related products decreased 6.9% on slightly lower volumes. The Company believes the net overall sales decline in municipal water sales was a function of the quarter's particular sales mix and factors affecting market conditions, including continuing municipal spending concerns that have been delaying ordering decisions, slower housing starts and the Company's introduction in early 2011 of the next generation of the ORION product that is causing water utilities to take time to evaluate this new technology. Concerns still exist about the state of the economy, which affects short-term buying decisions by the Company's customers.

Industrial flow products represented 26.3% of sales for the three months ended June 30, 2012. These sales increased \$9.4 million, or 77.0%, to \$21.6 million from \$12.2 million in the same period last year. As noted above, Racine Federated was acquired on January 31, 2012 and their sales were included from that point forward. Within this product grouping, Racine Federated's sales were \$9.1 million. The remainder of the increase was due to slightly higher sales in the remaining industrial flow product lines.

Specialty application products represented 9.1% of sales for the three months ended June 30, 2012. These sales decreased \$1.0 million in the second quarter of 2012, or 11.8%, to \$7.5 million from \$8.5 million during the same period in 2011. Included in this product grouping was \$2.8 million of sales from Racine Federated, which mitigated the overall decline in this group. The decrease in sales was due to a 72% decline in the sales of radios into the natural gas market. The second quarter of 2011 included significant sales of radios to one particular natural gas customer that did not recur this quarter. The decline was also affected by decreased sales of valves due to lower quantities sold.

The gross margin as a percentage of sales was 36.8% in the second quarter of 2012 compared to 36.2% in the second quarter of 2011. The net increase was due in part to the addition of Racine Federated's products, whose margins are generally a higher percentage than the Company's overall weighted margin percentage. Margins also increased due to lower costs for castings which fluctuate with the metals market. Offsetting these margin increases were a product mix with lower sales of municipal technology products and lower sales of radios to natural gas utilities.

Selling, engineering and administration expenses for the three months ended June 30, 2012 increased \$3.9 million, or 26.1%, over the same period in 2011. The increase was primarily attributable to the acquisition of Racine Federated and amortization of intangibles acquired, which were not included in the results for the second quarter of 2011. The remainder of the increase was due to higher employee incentives, and normal inflationary increases, offset by continuing cost control measures.

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Operating earnings for the second quarter of 2012 decreased \$0.9 million, or 7.5%, to \$11.4 million compared to \$12.3 million in 2011, as a net result of lower sales of municipal and specialty products and higher selling, engineering and administration expenses, offset somewhat by the addition of Racine Federated.

Interest expense for the quarter ended June 30, 2012 increased to \$0.2 million from \$0.1 million in the same period last year as a result of increased debt associated with the acquisition of Racine Federated and funds borrowed for the Company's stock repurchase program.

The provision for income taxes as a percentage of earnings before income taxes for the second quarter of 2012 was 33.1% compared to 35.7% in the second quarter of 2011. The decrease was due to recognition in tax expense in 2012 of favorable state income tax audit outcomes for prior periods.

As a result of the above mentioned items, net earnings for the three months ended June 30, 2012 were \$7.4 million, or \$0.52 per diluted share, compared to \$7.8 million, or \$0.52 per diluted share, for the same period in 2011. The per share amounts are similar despite different net earnings amounts due to the effects of the Company's stock repurchase program, which was completed in the second quarter of 2012.

**Results of Operations Six Months Ended June 30, 2012**

The Company's net sales for the six months ended June 30, 2012 increased \$25.7 million, or 19.4%, to \$158.2 million compared to \$132.5 million during the same period in 2011. The increase was due in part to the inclusion of Racine Federated's sales in the 2012 amounts as a result of the acquisition on January 31, 2012. Racine Federated's sales for the five months since acquisition were \$19.3 million. The remainder of the increase was due to higher municipal water product sales, offset by lower sales of specialty products due to fewer radios sold to natural gas utilities.

Municipal water sales increased \$12.0 million, or 12.9%, from \$93.3 million in the first six months of 2011 to \$105.3 million in the first six months of 2012. These sales represented 66.6% of sales for the six months ended June 30, 2012. The increase was due principally to higher sales of residential meters sold with technology and higher commercial meter sales. Sales of the Company's ORION AMR technology products decreased by less than 1.0%, while sales of the Itron related products increased 4.8%. In the first six months of 2012, ORION related products outsold Itron related products by a ratio of nearly 2.4 to 1. Manually read residential meter sales declined due to slightly lower volumes. Commercial meter sales increased 36.0% in this period over the same period in 2011 due to higher volumes of products sold. Sales of Galaxy fixed network related products increased 30.4% on significantly higher volumes. The Company believes the net overall volume increases represent a return to more normal buying patterns following a period of uncertainty about a number of factors, including municipal spending concerns that had been delaying ordering decisions, slower housing starts and the Company's introduction in early 2011 of the next generation of the ORION product that is causing water utilities to take time to evaluate this new technology. Concerns still exist about the state of the economy, which affects short-term buying decisions by the Company's customers.

Industrial flow products represented 24.8% of sales for the six months ended June 30, 2012. These sales increased \$17.5 million, or 80.1%, to nearly \$39.3 million from \$21.8 million in the same period last year. As noted above, Racine Federated was acquired on January 31, 2012 and their sales were included from that point forward. Within this product grouping, Racine Federated's sales were \$15.1 million. The remainder of the increase was due to higher sales in nearly all industrial flow product lines.

Specialty application products represented 8.6% of sales for the six months ended June 30, 2012. These sales decreased \$3.8 million in the six month period ended June 30, 2012, or 21.8%, to \$13.6 million from \$17.4 million during the same period in 2011. Included in this product grouping was \$4.2 million of sales from Racine Federated, which mitigated the overall decline in this group. The decrease in sales was due to a 78% decline in the sales of radios into the natural gas market. The first six months of 2011 included significant sales of radios to one particular natural gas customer that did not recur in the similar period in 2012.

The gross margin as a percentage of sales was 37.3% for the first six months of 2012 compared to 36.0% in the same period in 2011. The net increase was due in part to the addition of Racine Federated's products, whose margins are generally a higher percentage than the Company's overall weighted margin percentage. Margins also increased due to lower costs for castings which costs fluctuate with the metals market, as well as the slightly higher volumes of products sold. Offsetting these margin increases were lower sales of radios to natural gas utilities.

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Selling, engineering and administration expenses for the six months ended June 30, 2012 increased \$7.4 million, or 24.5%, over the same period in 2011. The increase was primarily attributable to the acquisition of Racine Federated and amortization of intangibles acquired, which were not included in the results for the first six months of 2011. The remainder of the increase was due to higher employee incentives and normal inflationary increases, offset by continuing cost control measures.

Operating earnings for the first six months of 2012 increased \$4.0 million, or 23.0%, to \$21.5 million compared to \$17.5 million in 2011, due to the higher municipal sales, the addition of Racine Federated and slightly lower product costs.

Interest expense for the first six months of 2012 increased to \$0.4 million from \$0.2 million in the same period last year as a result of increased debt associated with the acquisition of Racine Federated and funds borrowed for the Company's stock repurchase program.

The provision for income taxes as a percentage of earnings before income taxes for the first six months of 2012 was 35.1% compared to 35.9% in the same period in 2011. The decrease was due to recognition in tax expense in 2012 of favorable state income tax audit outcomes for prior periods.

As a result of the above mentioned items, net earnings for the six month period ended June 30, 2012 were \$13.7 million, or \$0.94 per diluted share, compared to \$11.1 million, or \$0.74 per diluted share, for the same period in 2011.

## **Liquidity and Capital Resources**

The main sources of liquidity for the Company are cash from operations and borrowing capacity. Cash provided by operations was \$14.1 million for the first six months of 2012 compared to \$17.8 million in the same period in 2011. The cash impact of higher earnings for the first six months of 2012 and increased payables was more than offset by increased receivables and inventories.

The receivables balance increased from \$41.2 million at December 31, 2011 to \$51.7 million at June 30, 2012 due principally to the acquisition of Racine Federated's receivables as well as higher overall sales. Generally, sales are lower in the fourth quarter resulting in lower receivable balances at year end. The Company believes its net receivables balance is fully collectible.

Inventories at June 30, 2012 increased \$11.7 million to \$61.1 million from \$49.4 million at December 31, 2011. Much of the increase was due to the acquisition of Racine Federated with the remainder due to the timing of purchases.

Prepaid expenses and other current assets at June 30, 2012 increased to \$3.4 million from \$2.3 million at December 31, 2011 due primarily to the payment of certain calendar year insurance premiums that are expensed ratably over the policy terms.

Net property, plant and equipment at June 30, 2012 increased to \$68.2 million from \$66.1 million at December 31, 2011 due to the purchase of Racine Federated and normal capital expenditures, partially offset by depreciation expense.

The increase in intangible assets to \$61.2 million at June 30, 2012 from \$33.7 million at December 31, 2011 was due to the acquisition of Racine Federated, offset slightly by normal amortization. The acquisition also resulted in an increase in goodwill from \$9.4 million at December 31, 2011 to \$35.7 million at June 30, 2012. The June 30, 2012 intangibles and goodwill amounts are based on preliminary valuations for Racine Federated and are subject to revision.

Short-term debt increased from \$1.8 million at December 31, 2011 to \$77.8 million at June 30, 2012. The increase was due to funds borrowed for the purchase of Racine Federated and the repurchase of stock by the Company under a program approved by its Board of Directors in November 2011 to repurchase up to \$30.0 million of the Company's Common stock, which was completed in the second quarter of 2012.



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Payables increased to \$18.9 million at June 30, 2012 from \$11.4 million at December 31, 2011 due primarily to the timing of payments and the acquisition of Racine Federated.

Accrued compensation and employee benefits increased to \$7.8 million at June 30, 2012 from \$6.7 million at December 31, 2011 as a result of the Racine Federated acquisition.

Accrued income and other taxes increased to \$1.5 million at June 30, 2012 from \$0.9 million at December 31, 2011 due to current year accruals for taxes and the timing of income tax payments.

Other long-term liabilities increased to \$5.6 million at June 30, 2012 from \$1.1 million at December 31, 2011 primarily due to \$4.6 million owed to the sellers of Racine Federated that is to be paid July 31, 2013.

At June 30, 2012, the Company had long-term deferred income tax liabilities of \$10.2 million compared to a long-term deferred income tax asset of \$2.3 million at December 31, 2011. This net change was the result of recording certain deferred tax liabilities in connection with the purchase of Racine Federated.

The overall reduction in total shareholders' equity from \$179.3 million at December 31, 2011 to \$159.8 million at June 30, 2012 was the net effect of net earnings and stock options exercised, offset by dividends paid and \$30.0 million of Common stock repurchased and retired by the Company under the current stock repurchase program.

The Company's financial condition remains strong. In May 2012, the Company signed a new credit agreement which increased its principal line of credit (increasing it from \$90.0 million to \$125.0 million) with its primary lender for a three year period. The line will be permanently reduced by \$16.7 million annually. This facility is unsecured, but there are a number of covenants in effect for the period to which the Company is in compliance. The Company believes that its operating cash flows, available borrowing capacity, and its ability to raise capital provide adequate resources to fund ongoing operating requirements, future capital expenditures and the development of new products. The Company continues to take advantage of its local commercial paper market and carefully monitors the current borrowing market. The Company had \$56.0 million of unused credit lines available at June 30, 2012.

## **Other Matters**

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

The Company is subject to contingencies related to environmental laws and regulations. The Company is named as one of many potentially responsible parties in two landfill lawsuits. The landfill sites are impacted by the Federal Comprehensive Environmental Response, Compensation and Liability Act and other environmental laws and regulations. At this time, the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. This belief is based on the Company's assessment of its limited past involvement with these landfill sites as well as the substantial involvement of and government focus on other named third parties with these landfill sites. However, due to the inherent uncertainties of such proceedings, the Company cannot predict the ultimate outcome of any of these matters. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2011 and the first half of 2012 were not material.

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

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The Company has been named as a defendant in two pending patent infringement lawsuits. One of these lawsuits alleges the Company and other parties infringed a patent on a metering data feature. The other lawsuit alleges the Company and other parties infringed an automotive lubrication product patent. As part of its sales contracts, the Company indemnifies customers for intellectual property infringement claims on its products and pays for certain costs, damages and fees if applicable conditions are met. The complaints seek unspecified damages as well as injunctive relief. The Company believes these claims are without merit and it is vigorously defending its interests. Although it is not possible to predict the ultimate outcome of these matters, the Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole.

See the Special Note Regarding Forward Looking Statements at the front of this Quarterly Report on Form 10-Q and Part I, Item 1A Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for a discussion of risks and uncertainties that could impact the Company's financial performance and results of operations.

### **Off-Balance Sheet Arrangements and Contractual Obligations**

The Company's off-balance sheet arrangements and contractual obligations are discussed in Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations under the headings Off-Balance Sheet Arrangements and Contractual Obligations in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and have not materially changed since that report was filed unless otherwise indicated in this Form 10-Q.

### **Item 3 Quantitative and Qualitative Disclosures about Market Risk**

The Company's quantitative and qualitative disclosures about market risk are included in Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading Market Risks in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and have not materially changed since that report was filed.

### **Item 4 Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act), the Company's management evaluated, with the participation of the Company's Chairman, President and Chief Executive Officer and the Company's Senior Vice President Finance, Chief Financial Officer and Treasurer, the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the quarter ended June 30, 2012. Based upon their evaluation of these disclosure controls and procedures, the Company's Chairman, President and Chief Executive Officer and the Company's Senior Vice President Finance, Chief Financial Officer and Treasurer concluded that as of the date of such evaluation, the Company's disclosure controls and procedures were effective.

#### **Changes in Internal Control over Financial Reporting**

There was no change in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****Part II Other Information****Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**

The following table summarizes the purchases made by or on behalf of the Company of shares of its Common stock during the quarterly period ended June 30, 2012.

| Period           | Total number of shares purchased<br>(a) | Average price paid per share<br>(b) | Total number of shares purchased as part of publicly announced plans or programs<br>(c) | Maximum number of shares that may yet be purchased under the plans or programs (1)<br>(d) |
|------------------|---|-------------------------------------|---|---|
| April 1 30, 2012 | 192,321                                 | \$34.36                             | 192,321   | 186,700   |
| May 1 31, 2012   | 113,618                                 | \$36.78                             | 113,618   | 60,000  |
| June 1 30, 2012  | 62,117                                  | \$35.42                             | 62,117  |   |
| Total            | 368,056                                 | \$33.78                             | 368,056   |   |

- (1) On November 11, 2011, the Company announced that its Board of Directors authorized the purchase of up to \$30.0 million of its Common stock in open market or negotiated transactions over a two-year period. Management was given discretion to determine the number and pricing of the shares to be purchased, as well as the timing of any such purchases. Shares remaining to be purchased were estimated based on the average price of shares purchased during each period.

**Item 6 Exhibits**

| Exhibit No. | Description   |
|-------------|---|
| 4.1         | Loan Agreement dated May 23, 2012 between Badger Meter, Inc. and BMO Harris Bank NA relating to Badger Meter, Inc.'s credit agreement.  |
| 31.1        | Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2        | Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32          | Certification of Periodic Financial Report by the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101         | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Condensed Balance Sheets, (ii) the Consolidated Condensed Statements of Operations, (iii) the Consolidated Condensed Statements of Comprehensive Income, (iv) the Consolidated Condensed Statements of Cash Flows and (v) Notes to Unaudited Consolidated Condensed Financial Statements, tagged as blocks of text. |

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**SIGNATURES**

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

BADGER METER, INC.

Dated: August 2, 2012

By /s/ Richard A. Meeusen  
Richard A. Meeusen  
Chairman, President and Chief Executive Officer

By /s/ Richard E. Johnson  
Richard E. Johnson  
Senior Vice President Finance, Chief Financial Officer and  
Treasurer

By /s/ Beverly L. P. Smiley  
Beverly L. P. Smiley  
Vice President Controller

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**BADGER METER, INC.**

**Quarterly Report on Form 10-Q for the Period Ended June 30, 2012**

**Exhibit Index**

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
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