

BADGER METER INC
Form 10-Q
October 23, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended September 30, 2009**

**BADGER METER, INC.
4545 W. Brown Deer Road
Milwaukee, Wisconsin 53223
(414) 355-0400**

A Wisconsin Corporation
IRS Employer Identification No. 39-0143280
Commission File No. 001-06706

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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). (Registrant is not yet required to provide financial disclosure in an Interactive Data File format.)

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 <input type="checkbox"/> | Accelerated filer <input checked="" type="checkbox"/> | Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |
|--|---|---|--|

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 13, 2009, there were 14,949,417 shares of Common Stock outstanding with a par value of \$1 per share.

BADGER METER, INC.
Quarterly Report on Form 10-Q for Period Ended September 30, 2009
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Special Note Regarding Forward Looking Statements

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

the continued shift in the Company's business from lower cost, manually read meters toward more expensive, value-added automatic meter reading (AMR) systems and advanced metering infrastructure (AMI) systems;

the success or failure of newer Company products;

changes in competitive pricing and bids in both the domestic and foreign marketplaces, and in particular 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 the current global economic downturn, 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 impact of the United States and foreign government programs to stimulate national and global economies;

changes in the cost and/or availability of needed raw materials and parts, including recent 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 and plastic resin as a result of changes in petroleum and natural gas prices;

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

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 U.S. Federal Communications

Commission rules affecting the use and/or licensing of radio frequencies necessary for AMR/AMI products.

All of these factors are beyond the Company's control to varying degrees. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward looking statements and are cautioned not to place undue reliance on such forward looking statements. The forward looking statements made in

this document are made only as of the date of this document and the Company assumes no obligation, and disclaims any obligation, to update any such forward looking statements to reflect subsequent events or circumstances.

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

| | September 30, 2009 (Unaudited) | December 31, 2008 |
|--|---|-------------------------|
| | (In thousands) | |
| Assets | | |
| Current assets: | | |
| Cash | \$ 10,920 | \$ 6,217 |
| Receivables | 36,643 | 35,767 |
| Inventories: | | |
| Finished goods | 11,366 | 13,484 |
| Work in process | 9,245 | 10,990 |
| Raw materials | 15,674 | 14,841 |
| Total inventories | 36,285 | 39,315 |
| Prepaid expenses and other current assets | 3,052 | 2,316 |
| Deferred income taxes | 2,905 | 2,914 |
| Total current assets | 89,805 | 86,529 |
| Property, plant and equipment, at cost | 139,006 | 133,934 |
| Less accumulated depreciation | (76,337) | (72,111) |
| Net property, plant and equipment | 62,669 | 61,823 |
| Intangible assets, at cost less accumulated amortization | 23,960 | 25,030 |
| Other assets | 6,133 | 5,713 |
| Deferred income taxes | 5,268 | 9,305 |
| Goodwill | 6,958 | 6,958 |
| Total assets | \$ 194,793 | \$ 195,358 |
| Liabilities and shareholders equity | | |
| Current liabilities: | | |
| Short-term debt | \$ 6,716 | \$ 9,995 |
| Current portion of long-term debt | 7,895 | 9,675 |
| Payables | 14,231 | 13,230 |
| Accrued compensation and employee benefits | 6,442 | 8,714 |
| Warranty and after-sale costs | 1,168 | 1,327 |
| Income and other taxes | 437 | 7,848 |
| Total current liabilities | 36,889 | 50,789 |

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|---|------------|------------|
| Other long-term liabilities | 1,145 | 1,059 |
| Deferred income taxes | | 133 |
| Accrued non-pension postretirement benefits | 5,815 | 5,585 |
| Other accrued employee benefits | 12,862 | 21,265 |
| Long-term debt | | 5,504 |
| Commitments and contingencies (Note 6) | | |
| Shareholders' equity: | | |
| Common stock | 21,189 | 21,074 |
| Capital in excess of par value | 33,444 | 31,563 |
| Reinvested earnings | 131,931 | 107,887 |
| Accumulated other comprehensive loss | (15,866) | (16,672) |
| Less:Employee benefit stock | (585) | (659) |
| Treasury stock, at cost | (32,031) | (32,170) |
| Total shareholders' equity | 138,082 | 111,023 |
| Total liabilities and shareholders' equity | \$ 194,793 | \$ 195,358 |

See accompanying notes to consolidated condensed financial statements.

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BADGER METER, INC.
Consolidated Condensed Statements of Operations

| | Three Months Ended September 30, (Unaudited) | | Nine Months Ended September 30, (Unaudited) | |
|--|--|-----------|---|------------|
| | (In thousands except share and per share amounts) | | | |
| | 2009 | 2008 | 2009 | 2008 |
| Net sales | \$ 60,814 | \$ 68,826 | \$ 193,901 | \$ 211,906 |
| Cost of sales | 37,089 | 45,418 | 117,403 | 137,600 |
| Gross margin | 23,725 | 23,408 | 76,498 | 74,306 |
| Selling, engineering and administration | 13,057 | 14,221 | 41,705 | 43,500 |
| Operating earnings | 10,668 | 9,187 | 34,793 | 30,806 |
| Interest expense | (962) | 379 | (255) | 966 |
| Earnings from continuing operations before income taxes | 11,630 | 8,808 | 35,048 | 29,840 |
| Provision for income taxes | 4,665 | 2,980 | 13,353 | 10,951 |
| Earnings from continuing operations | 6,965 | 5,828 | 21,695 | 18,889 |
| Earnings from discontinued operations net of income taxes | 7,390 | | 7,390 | |
| Net earnings | \$ 14,355 | \$ 5,828 | \$ 29,085 | \$ 18,889 |
| Per share amounts: | | | | |
| Earnings per share: | | | | |
| Basic from continuing operations | \$ 0.47 | \$ 0.40 | \$ 1.47 | \$ 1.30 |
| Basic from discontinued operations | \$ 0.50 | \$ | \$ 0.50 | \$ |
| Total basic | \$ 0.97 | \$ 0.40 | \$ 1.97 | \$ 1.30 |

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| | | | | | | | | |
|---|----|------------|----|------------|----|------------|----|------------|
| Diluted from continuing operations | \$ | 0.47 | \$ | 0.39 | \$ | 1.45 | \$ | 1.27 |
| Diluted from discontinued operations | \$ | 0.49 | \$ | | \$ | 0.50 | \$ | |
| Total diluted | \$ | 0.96 | \$ | 0.39 | \$ | 1.95 | \$ | 1.27 |
| Dividends declared - Common stock | \$ | 0.12 | \$ | 0.11 | \$ | 0.34 | \$ | 0.29 |
| Shares used in computation of earnings per share: | | | | | | | | |
| Basic | | 14,830,871 | | 14,618,072 | | 14,774,985 | | 14,517,580 |
| Impact of dilutive securities | | 130,633 | | 259,725 | | 159,964 | | 309,742 |
| Diluted | | 14,961,504 | | 14,877,797 | | 14,934,949 | | 14,827,322 |

See accompanying notes to consolidated condensed financial statements.

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BADGER METER, INC.
Consolidated Condensed Statements of Cash Flows

| | Nine Months Ended September 30, (Unaudited) (In thousands) | |
|--|---|-----------|
| | 2009 | 2008 |
| Operating activities: | | |
| Net earnings | \$ 29,085 | \$ 18,889 |
| Adjustments to reconcile net earnings to net cash provided by (used for) operations: | | |
| Depreciation | 5,309 | 4,757 |
| Amortization | 1,070 | 740 |
| Deferred income taxes | 3,908 | (12) |
| Noncurrent employee benefits | 2,746 | 2,572 |
| Contribution to pension plan | (10,100) | |
| Stock-based compensation expense | 811 | 839 |
| Changes in: | | |
| Receivables | 208 | (5,255) |
| Inventories | 3,162 | (10,836) |
| Prepaid expenses and other current assets | (744) | (405) |
| Current liabilities other than debt | (10,868) | 3,686 |
| Total adjustments | (4,498) | (3,914) |
| Net cash provided by operations | 24,587 | 14,975 |
| Investing activities: | | |
| Property, plant and equipment additions | (6,008) | (10,467) |
| Acquisition of intangible assets | | (25,650) |
| Other net | (443) | (691) |
| Net cash used for investing activities | (6,451) | (36,808) |
| Financing activities: | | |
| Net increase (decrease) in short-term debt | (3,346) | 4,732 |
| Issuance of long-term debt | | 15,000 |
| Repayments of long-term debt | (7,284) | (3,349) |
| Dividends paid | (5,039) | (4,231) |
| Proceeds from exercise of stock options | 1,023 | 2,002 |
| Tax benefit on stock options | 989 | 3,971 |
| Issuance of treasury stock | 136 | 136 |
| Net cash provided by (used for) financing activities | (13,521) | 18,261 |

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| | | |
|--|-----------|----------|
| Effect of foreign exchange rates on cash | 88 | (154) |
| Increase (decrease) in cash | 4,703 | (3,726) |
| Cash beginning of period | 6,217 | 8,670 |
| Cash end of period | \$ 10,920 | \$ 4,944 |

See accompanying notes to consolidated condensed financial statements.

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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 September 30, 2009, results of operations for the three- and nine-month periods ended September 30, 2009 and 2008, and cash flows for the nine-month periods ended September 30, 2009 and 2008. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

Effective June 30, 2009, the Company adopted Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 855, Subsequent Events. ASC Topic 855 addresses the types and timing of events that should be reported in the financial statements for events occurring between the balance sheet date and the date the financial statements are issued or available to be issued. The Company reviewed subsequent events for inclusion in the financial statements through October 23, 2009, the date that the accompanying financial statements were issued. The adoption of the ASC Topic did not impact the Company's financial position or results of operations.

Note 2 Additional Balance Sheet Information

The consolidated condensed balance sheet at December 31, 2008 was derived from amounts included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. 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 analysis of water quality issues. Changes in the Company's warranty and after-sale costs reserve for the nine-month periods ended September 30, 2009 and 2008 are as follows:

| | Balance at beginning of year | Net additions charged to earnings | Costs incurred and adjustments | Balance at September 30 |
|----------------|---------------------------------------|--|---|----------------------------------|
| (In thousands) | | | | |
| 2009 | \$ 1,327 | \$ 512 | \$ (671) | \$ 1,168 |
| 2008 | \$ 1,917 | \$ 390 | \$ (639) | \$ 1,668 |
| | | 7 | | |

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The Company maintains a non-contributory defined benefit pension plan for its domestic employees and a non-contributory postretirement plan that provides medical benefits for certain domestic retirees and eligible dependents. The following table sets forth the components of net periodic benefit cost for the three months ended September 30, 2009 and 2008 based on December 31, 2008 and September 30, 2007 actuarial measurement dates, respectively:

| (In thousands) | Pension benefits | | Other postretirement benefits | |
|--|------------------|--------|-------------------------------|--------|
| | 2009 | 2008 | 2009 | 2008 |
| Service cost benefits earned during the year | \$ 450 | \$ 493 | \$ 32 | \$ 37 |
| Interest cost on projected benefit obligations | 748 | 686 | 102 | 101 |
| Expected return on plan assets | (846) | (864) | | |
| Amortization of prior service cost (credit) | (16) | (36) | 48 | 45 |
| Amortization of net loss | 262 | 290 | | 8 |
| Net periodic benefit cost | \$ 598 | \$ 569 | \$ 182 | \$ 191 |

The following table sets forth the components of net periodic benefit cost for the nine months ended September 30, 2009 and 2008 based on December 31, 2008 and September 30, 2007 actuarial measurement dates, respectively:

| (In thousands) | Pension benefits | | Other postretirement benefits | |
|--|------------------|----------|-------------------------------|--------|
| | 2009 | 2008 | 2009 | 2008 |
| Service cost benefits earned during the year | \$ 1,353 | \$ 1,479 | \$ 93 | \$ 111 |
| Interest cost on projected benefit obligations | 2,246 | 2,058 | 295 | 303 |
| Expected return on plan assets | (2,540) | (2,592) | | |
| Amortization of prior service cost (credit) | (48) | (108) | 140 | 135 |
| Amortization of net loss | 785 | 870 | | 24 |
| Net periodic benefit cost | \$ 1,796 | \$ 1,707 | \$ 528 | \$ 573 |

The Company previously disclosed in its financial statements for the year ended December 31, 2008 that it anticipated making a contribution of \$4.9 million to its pension plan in 2009 for the 2008 plan year due to the reduction in the market value of the underlying investments as of the December 31, 2008 actuarial measurement date. During the second and third quarters of 2009, the Company made aggregate contributions of \$9.1 million toward the 2008 plan year that increased the funded status of the Company's pension plan. In addition, the Company made a contribution totaling \$1.0 million for the 2009 plan year. The Company believes no additional contributions will be required for 2009.

The Company disclosed in its financial statements for the year ended December 31, 2008 that it estimated it would pay \$0.6 million in other postretirement benefits in 2009 based on actuarial estimates. As of September 30, 2009, \$158,000 of such benefits were paid. The Company believes that its estimated payments for the full year may be less than the prior full-year estimate. However, such estimates contain inherent uncertainties because cash payments can vary significantly depending on the timing of postretirement medical claims and the collection of the retiree's portion of certain costs. Note that the amount of benefits paid in calendar year 2009 will not impact the expense for postretirement benefits for 2009.

Note 4 Guarantees

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The Company guarantees the outstanding debt of the Badger Meter Employee Savings and Stock Ownership Plan (ESSOP) that is recorded in short-term debt, offset by a similar amount of unearned compensation that has been recorded as a reduction of shareholders' equity. The loan amount is collateralized by shares of the Company's Common Stock. A payment of \$74,000 was made in the first quarter of 2009 that reduced the debt and the corresponding employee benefit stock balance included in shareholders' equity.

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Comprehensive income for the three-month periods ended September 30, 2009 and 2008 was \$14.8 million and \$5.7 million, respectively. Comprehensive income for the nine-month periods ended September 30, 2009 and 2008 was \$29.9 million and \$19.6 million, respectively.

Components of accumulated other comprehensive loss are as follows:

| (In thousands) | September 30, 2009 | December 31, 2008 |
|--|-----------------------------------|----------------------------------|
| Cumulative foreign currency translation adjustment | \$ 1,840 | \$ 1,639 |
| Unrecognized pension and postretirement benefit plan liabilities (net of tax of \$10.8 million and \$11.2 million for 2009 and 2008, respectively) | (17,706) | (18,311) |
| Accumulated other comprehensive loss | \$(15,866) | \$ (16,672) |

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. Currently, the Company is in the process of resolving matters relating to two landfill sites where it has been named as one of many potentially responsible parties and to a parcel of land adjoining the Company's property. The landfill sites are impacted by the Federal Comprehensive Environmental Response, Compensation and Liability Act and other environmental laws and regulations. At this time, the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. 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 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 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, or with respect to off-site disposal locations used by the Company, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2008 and the first three quarters of 2009 were not material.

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

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

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

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Note 7 Discontinued Operations

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