BADGER METER INC
Form 10-Q
July 25, 2008

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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, 2008
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. 1-6706

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

Yes þ No o

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

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

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

Yes o No þ

As of July 15, 2008, there were 14,655,385 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 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 and objective or similar expressions are intended 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, manual 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, including the Orion® radio frequency AMR system, the Galaxy® fixed network AMI system and the low profile Recordall® Model LP disc series meter;

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, manual 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, housing starts in the United States and overall industrial activity;

increases in the cost and/or availability of needed raw materials and parts, including recent increases in the cost of brass castings as a result of increases in commodity prices, particularly for copper and scrap metal, at the supplier level and plastic resin as a result of increases 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 between the United States dollar and the euro;

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.

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Part I Financial Information

Item 1 Financial Statements

BADGER METER, INC.
Consolidated Condensed Balance Sheets

	June 30, 2008 (Unaudited)	December 31, 2007
	(In thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 5,401	$ 8,670
Receivables	38,043	30,638
Inventories:		
Finished goods	8,758	8,225
Work in process	15,150	10,660
Raw materials	15,621	15,209
Total inventories	39,529	34,094
Prepaid expenses and other current assets	4,485	3,450
Deferred income taxes	3,101	3,082
Total current assets	90,559	79,934
Property, plant and equipment, at cost	132,727	125,678
Less accumulated depreciation	(73,549)	(71,100)
Net property, plant and equipment	59,178	54,578
Intangible assets, at cost less accumulated amortization	25,742	477
Other assets	5,535	4,919
Deferred income taxes	3,435	3,435
Goodwill	6,958	6,958
Total assets	$ 191,407	$ 150,301
Liabilities and shareholders equity		
Current liabilities:		
Short-term debt	$ 32,688	$ 10,844
Current portion of long-term debt	2,116	2,738
Payables	14,798	11,363
Accrued compensation and employee benefits	7,017	5,988
Warranty and after-sale costs	2,008	1,917
Income and other taxes	10,907	8,359
Total current liabilities	69,534	41,209

Other long-term liabilities	580	627
Deferred income taxes	251	244
Accrued non-pension postretirement benefits	6,252	6,083
Other accrued employee benefits	7,094	7,040
Long-term debt	2,714	3,129
Commitments and contingencies		
Shareholders equity:		
Common stock	20,929	20,902
Capital in excess of par value	25,817	24,655
Reinvested earnings	99,505	89,061
Accumulated other comprehensive loss	(8,427)	(9,191)
Less:Employee benefit stock	(658)	(682)
Treasury stock, at cost	(32,184)	(32,776)
Total shareholders equity	104,982	91,969
Total liabilities and shareholders equity	$ 191,407	$ 150,301

See accompanying notes to consolidated condensed financial statements.

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BADGER METER, INC.
Consolidated Condensed Statements of Operations

	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	(In thousands except share and per share amounts)			
	2008	2007	2008	2007
Net sales	$ 74,660	$ 62,173	$ 143,080	$ 114,836
Cost of sales	48,286	39,639	92,182	76,047
Gross margin	26,374	22,534	50,898	38,789
Selling, engineering and administration	14,624	13,118	29,279	25,103
Operating earnings	11,750	9,416	21,619	13,686
Interest expense	335	315	587	667
Earnings from continuing operations before income taxes	11,415	9,101	21,032	13,019
Provision for income taxes	4,374	3,381	7,971	4,830
Earnings from continuing operations	7,041	5,720	13,061	8,189
Loss from discontinued operations net of income taxes		(252)		(149)
Net earnings	$ 7,041	$ 5,468	$ 13,061	$ 8,040
Earnings (loss) per share amounts:				
Basic:				
from continuing operations	$ 0.49	$ 0.40	$ 0.90	$ 0.58
from discontinued operations	$	$ (0.01)	$	$ (0.01)
Total basic	$ 0.49	$ 0.39	$ 0.90	$ 0.57
Diluted:				
from continuing operations	$ 0.48	$ 0.39	$ 0.88	$ 0.56

from discontinued operations	$	$ (0.01)	$	$ (0.01)
Total diluted	$ 0.48	$ 0.38	$ 0.88	$ 0.55
Dividends declared	$ 0.09	$ 0.08	$ 0.18	$ 0.16
Shares used in computation of earnings per share:				
Basic	14,509,709	14,167,554	14,466,785	14,102,764
Impact of dilutive securities	314,127	399,466	334,751	440,340
Diluted	14,823,836	14,567,020	14,801,536	14,543,104

See accompanying notes to consolidated condensed financial statements.

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BADGER METER, INC.
Consolidated Condensed Statements of Cash Flows

	Six Months Ended June 30, (Unaudited) (In thousands)	
	2008	2007
Operating activities:		
Net earnings	$ 13,061	$ 8,040
Adjustments to reconcile net earnings to net cash provided by (used for) operations:		
Depreciation	3,336	3,372
Amortization	385	82
Deferred income taxes	(19)	(11)
Noncurrent employee benefits	1,721	1,315
Stock-based compensation expense	573	445
Gain on disposal of long-lived assets		(495)
Changes in:		
Receivables	(7,083)	(7,397)
Inventories	(5,223)	(516)
Prepaid expenses and other current assets	(990)	(685)
Current liabilities other than debt	4,572	6,440
Total adjustments	(2,728)	2,550
Net cash provided by operations	10,333	10,590
Investing activities:		
Property, plant and equipment additions	(7,490)	(9,904)
Proceeds on disposal of long-lived assets		3,194
Acquisition of intangible assets	(25,650)	
Other net	(621)	(10)
Net cash provided by (used for) investing activities	(33,761)	(6,720)
Financing activities:		
Net increase (decrease) in short-term debt	21,649	(64)
Repayments of long-term debt	(1,037)	(956)
Dividends paid	(2,612)	(2,275)
Proceeds from exercise of stock options	968	719
Tax benefit on stock options	1,673	910
Issuance of treasury stock	74	95
Net cash provided by (used for) financing activities	20,715	(1,571)
Effect of foreign exchange rates on cash	(556)	(54)

Increase (decrease) in cash	(3,269)	2,245
Cash beginning of period from continuing operations	8,670	3,002
Cash beginning of period from discontinued operations		2,046
Cash beginning of period	8,670	5,048
Cash end of period from continuing operations	5,401	5,991
Cash end of period from discontinued operations		1,302
Cash end of period	$ 5,401	$ 7,293

See accompanying notes to consolidated condensed financial statements.

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BADGER METER, INC.
Notes to Unaudited Consolidated Condensed Financial Statements

Note 1 Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated condensed financial statements of Badger Meter, Inc. (the Company) contain all adjustments (consisting only of normal recurring accruals except as otherwise discussed) necessary to present fairly the Company s consolidated condensed financial position at June 30, 2008, results of operations for the three- and six-month periods ended June 30, 2008 and 2007, and cash flows for the six-month periods ended June 30, 2008 and 2007. 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.

Note 2 Additional Balance Sheet Information

The consolidated condensed balance sheet at December 31, 2007 was derived from amounts included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007. 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 six-month periods ended June 30, 2008 and 2007 are as follows:

(In thousands)	Balance at beginning of year	Net additions charged to earnings	Costs incurred	Balance at June 30
2008	$ 1,917	$ 577	$ (486)	$ 2,008
2007	$ 2,954	$ 173	$ (492)	$ 2,635

Note 3 Employee Benefit Plans

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

	Pension benefits		Other postretirement benefits	
(In thousands)	2008	2007	2008	2007
Service cost	$ 493	$ 496	$ 37	$ 49
Interest cost	686	629	101	105
Expected return on plan assets	(864)	(883)		
Amortization of prior service cost (credit)	(36)	(37)	45	
Amortization of net loss	290	282	8	28
Net periodic benefit cost	$ 569	$ 487	$ 191	$ 182

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The following table sets forth the components of net periodic benefit cost for the six months ended June 30, 2008 and 2007 based on a September 30 measurement date:

(In thousands)	Pension benefits 2008	Pension benefits 2007	Other postretirement benefits 2008	Other postretirement benefits 2007
Service cost	$ 986	$ 992	$ 74	$ 98
Interest cost	1,372	1,258	202	210
Expected return on plan assets	(1,728)	(1,766)		
Amortization of prior service cost (credit)	(72)	(74)	90	
Amortization of net loss	580	564	16	55
Net periodic benefit cost	$ 1,138	$ 974	$ 382	$ 363

The Company previously disclosed in its financial statements for the year ended December 31, 2007 that it did not expect to contribute funds to its pension plan in 2008. While the Company believes that it will not be required to make any such contributions in 2008, such belief is based upon the estimated return on plan assets as of the annual measurement date.

The Company disclosed in its financial statements for the year ended December 31, 2007 that it estimated it would pay $0.6 million in other postretirement benefits in 2008 based on actuarial estimates. As of June 30, 2008, $106,000 of such benefits were paid. The Company now believes that its estimated payments for the full year may be somewhat less than the 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 2008 will not impact the expense for postretirement benefits for the current year.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS 158). On December 31, 2006, the Company adopted the required provisions of SFAS 158 by recognizing the funded status of its defined benefit pension and postretirement benefit plans in the statement of financial position. Additionally, employers are required to measure the funded status of a plan as of the date of its year-end statement of financial position and provide additional disclosures. Prior to the adoption of the measurement date provisions of SFAS 158, the Company s pension plans previously used a September 30 measurement date. As permitted by the statement, the Company will adopt the measurement provisions of SFAS 158 during the fourth quarter for the 2008 full-year statements, at which time the Company expects to recognize a reduction of $0.4 million, net of tax, to the 2008 beginning of the year reinvested earnings. There will be no effect on the Company s results of operations or cash flows.

Note 4 Guarantees

The Company guarantees the outstanding debt of the Badger Meter Employee Savings and Stock Ownership Plan (ESSOP) that is recorded in long-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 $23,000 was made in the first quarter of 2008 that reduced the debt and the corresponding employee benefit stock balance included in shareholders equity.

Note 5 Comprehensive Income (Loss)

Comprehensive income for the three-month periods ended June 30, 2008 and 2007 was $7.2 million and $5.7 million, respectively. Comprehensive income for the six-month periods ended June 30, 2008 and 2007 was $13.8 million and $8.4 million, respectively.

Components of accumulated other comprehensive loss are as follows:

(In thousands)		June 30, 2008		December 31, 2007
Cumulative foreign currency translation adjustment	$	2,063	$	1,713
Unrecognized pension and postretirement benefit plan liabilities		(10,490)		(10,904)
Accumulated other comprehensive loss	$	(8,427)	$	(9,191)

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Note 6 Discontinued French Operations

During 2006, the Company carefully evaluated strategic alternatives for its subsidiaries in Nancy, France, including restructuring, sale or shutdown. In the third quarter of 2006, the Company began the process under French law to obtain the approvals to close the operations. On October 16, 2006, the decision to discontinue the Company s French operations was finalized, and all disposal transactions were completed by December 31, 2007. Information about the Company s discontinued French operations is included in the Notes to Consolidated Financial Statements in the Company s 2007 Annual Report on Form 10-K under the heading Note 3 Discontinued Operations.

For the three-month period ended June 30, 2007, net sales from the French operations were $58,000 and net losses were $0.3 million. For the six-month period ended June 30, 2007, net sales from the French operations were $1.9 million and net losses were $0.1 million.

Note 7 Acquisition of Intangible Assets

In April 2008, the Company acquired the advanced metering infrastructure (AMI) technology used in its Galaxy® fixed network system from Miltel Communications Ltd. for a purchase price of approximately $25.7 million. The technology agreement included the acquisition of the core technology, the exclusive right to manufacture the Galaxy® system and distribute it in certain water and gas utility markets, and a non-compete clause. The purchase price was recorded in the second quarter of 2008 as intangible assets that will be amortized over estimated lives of 20 and 10 years for the core technology and non-compete arrangement, respectively. This acquisition was initially funded from commercial paper drawn on the Company s short-term line of credit, which was amended in April 2008 to increase availability to accommodate this purchase.

In July 2008, the Company obtained a $15.0 million unsecured two-year loan that bears interest at 5.04% annually to refinance a portion of the existing short-term debt that funded this acquisition.

Note 8 Restricted Stock

On April 25, 2008, a restricted stock plan was approved which provides for the issuance of non-vested Common Stock to certain eligible employees. The plan authorizes the issuance of shares up to an aggregate of 100,000 shares of Common Stock (no individual participant may be granted more than 20,000 shares in the aggregate), of which 5,100 were issued in May 2008. The restricted stock issued in May is generally subject to a three-year cliff vesting period contingent on employment. Compensation expense related to the issuance of restricted stock was $37,881 for the quarter ended June 30, 2008.

Note 9 Contingencies, Litigation and Commitments

In the normal course of business, the Company is named in legal proceedings from time to time. There are currently no material legal proceedings pending with respect to the Company. The more significant legal proceedings are as 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. These 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 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 on the Company s assessment of its limited past involvement with these sites as well as the substantial involvement of other named third parties in these matters. 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.

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 has evaluated its worldwide operations to determine whether any risks and uncertainties exist that could severely impact its operations in the near term. Although the Company relies on single suppliers for certain castings and components in several of its product lines, alternate sources of supply exist for these items. Loss of certain suppliers could temporarily disrupt operations in the short term. The Company attempts to mitigate these risks by working closely with key suppliers, purchasing minimal amounts from alternative suppliers and by purchasing business interruption insurance where appropriate.

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

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

Business Description and Overview

The Company is a leading manufacturer and marketer of products incorporating liquid flow measurement and control technologies, which are developed both internally and in conjunction with other technology companies. Its products are used to measure and control the flow of liquids in a wide variety of applications. The Company s product lines fall into two general categories, utility and industrial flow measurement. The utility category is comprised of two primary product lines residential and commercial water meters that are used by water utilities as the basis for generating water and wastewater revenues. The market for these product lines is North America, primarily the United States, because these meters are designed and manufactured to conform to standards promulgated by the American Water Works Association. The utility flow measurement products constitute a majority of the Company s sales.

Industrial product line sales comprise the remainder of the Company s sal