

BADGER METER INC  
Form 10-Q  
October 26, 2011  
Table of Contents

**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, 2011

**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 October 13, 2011, there were 15,116,519 shares of Common Stock outstanding with a par value of \$1 per share.

**Table of Contents**

**BADGER METER, INC.**

**Quarterly Report on Form 10-Q for the Period Ended September 30, 2011**

**Index**

	Page No.
<b><u>Part I. Financial Information:</u></b>	
Item 1	<b><u>Financial Statements:</u></b>
	<b><u>Consolidated Condensed Balance Sheets – September 30, 2011 and December 31, 2010</u></b> 4
	<b><u>Consolidated Condensed Statements of Operations – Three and Nine Months Ended September 30, 2011 and 2010</u></b> 5
	<b><u>Consolidated Condensed Statements of Cash Flows – Nine Months Ended September 30, 2011 and 2010</u></b> 6
	<b><u>Notes to Unaudited Consolidated Condensed Financial Statements</u></b> 7
Item 2	<b><u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u></b> 10
Item 3	<b><u>Quantitative and Qualitative Disclosures about Market Risk</u></b> 16
Item 4	<b><u>Controls and Procedures</u></b> 16
<b><u>Part II. Other Information:</u></b>	
Item 6	<b><u>Exhibits</u></b> 17
	<b><u>Signatures</u></b> 18
	<b><u>Exhibit Index</u></b> 19

**Table of Contents**

**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 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 the new advanced metering analytics (AMA) systems that offer a complete solution 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 or disruption 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 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, 2011 (Unaudited)	December 31, 2010
	(In thousands)	
<b>Assets</b>		
Current assets:		
Cash	\$ 5,787	\$ 3,089
Receivables	43,195	40,429
Inventories:		
Finished goods	12,401	9,800
Work in process	10,282	15,284
Raw materials	25,102	23,232
Total inventories	47,785	48,316
Prepaid expenses and other current assets	2,992	2,381
Deferred income taxes	3,417	3,122
Total current assets	103,176	97,337
Property, plant and equipment, at cost	143,822	143,954
Less accumulated depreciation	(77,452)	(77,866)
Net property, plant and equipment	66,370	66,088
Intangible assets, at cost less accumulated amortization	34,323	34,170
Other assets	6,439	7,449
Deferred income taxes	1,006	1,658
Goodwill	9,162	9,162
Total assets	\$ 220,476	\$ 215,864
<b>Liabilities and shareholders equity</b>		
Current liabilities:		
Short-term debt	\$ 2,680	\$ 12,878
Payables	13,938	11,159
Accrued compensation and employee benefits	6,797	7,143
Warranty and after-sale costs	1,004	889
Income and other taxes	1,498	610
Total current liabilities	25,917	32,679
Other long-term liabilities	946	2,472
Accrued non-pension postretirement benefits	6,029	5,972
Other accrued employee benefits	4,842	6,358
Commitments and contingencies (Note 6)		

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Shareholders' equity:		
Common stock	21,289	21,259
Capital in excess of par value	38,866	37,582
Reinvested earnings	167,482	156,101
Accumulated other comprehensive loss	(11,727)	(13,137)
Less: Employee benefit stock	(1,485)	(1,536)
Treasury stock, at cost	(31,683)	(31,886)
Total shareholders' equity	182,742	168,383
Total liabilities and shareholders' equity	\$ 220,476	\$ 215,864

*See accompanying notes to consolidated condensed financial statements.*

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

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2011	2010	2011	2010
(In thousands except share and per share amounts)				
Net sales	\$ 69,698	\$ 75,702	\$ 202,205	\$ 211,791
Cost of sales	46,918	47,748	131,768	133,605
Gross margin	22,780	27,954	70,437	78,186
Selling, engineering and administration	14,791	14,518	44,933	43,022
Operating earnings	7,989	13,436	25,504	35,164
Interest expense (income)	(87)	95	121	275
Earnings before income taxes	8,076	13,341	25,383	34,889
Provision for income taxes	1,196	4,318	7,409	12,485
Net earnings	\$ 6,880	\$ 9,023	\$ 17,974	\$ 22,404
Per share amounts:				
Earnings per share:				
Basic	\$ 0.46	\$ 0.61	\$ 1.20	\$ 1.50
Diluted	\$ 0.46	\$ 0.60	\$ 1.19	\$ 1.49
Dividends declared - Common stock	\$ 0.16	\$ 0.14	\$ 0.44	\$ 0.38
Shares used in computation of earnings per share:				
Basic	14,989,366	14,910,497	14,959,202	14,897,901
Impact of dilutive securities	69,109	96,068	84,339	101,285
Diluted	15,058,475	15,006,565	15,043,541	14,999,186

*See accompanying notes to consolidated condensed financial statements.*



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

	Nine Months Ended September 30, (Unaudited) (In thousands)	
	2011	2010
<b>Operating activities:</b>		
Net earnings	\$ 17,974	\$ 22,404
Adjustments to reconcile net earnings to net cash provided by (used for) operations:		
Depreciation	5,458	5,211
Amortization	1,759	1,213
Gain on legal settlement	0	(740)
Deferred income taxes	(66)	2,158
Noncurrent employee benefits	1,476	2,399
Contribution to pension plan	0	(4,700)
Stock-based compensation expense	836	918
Changes in:		
Receivables	(2,636)	(16,964)
Inventories	1,667	(7,858)
Prepaid expenses and other current assets	(1,337)	(128)
Liabilities other than debt	1,184	9,751
Total adjustments	8,341	(8,740)
<b>Net cash provided by operations</b>	<b>26,315</b>	<b>13,664</b>
<b>Investing activities:</b>		
Property, plant and equipment expenditures	(3,696)	(6,962)
Acquisitions, net of cash acquired	(3,954)	(7,280)
Acquisition of intangible asset	0	(8,028)
Investment in start-up technology company	0	(1,500)
Other net	146	(62)
<b>Net cash used for investing activities</b>	<b>(7,504)</b>	<b>(23,832)</b>
<b>Financing activities:</b>		
Net increase (decrease) in short-term debt	(10,543)	10,607
Repayments of long-term debt	0	(5,429)
Dividends paid	(6,615)	(5,684)
Proceeds from exercise of stock options	251	228
Tax benefit on stock options	166	135
Employee benefit stock purchase, net	0	(1,000)
Issuance of treasury stock	468	121
<b>Net cash used for financing activities</b>	<b>(16,273)</b>	<b>(1,022)</b>
Effect of foreign exchange rates on cash	160	535
<b>Increase (decrease) in cash</b>	<b>2,698</b>	<b>(10,655)</b>

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Cash	beginning of period	3,089	13,329
Cash	end of period	\$ 5,787	\$ 2,674

*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 September 30, 2011, results of operations for the three- and nine-month periods ended September 30, 2011 and 2010, and cash flows for the nine-month periods ended September 30, 2011 and 2010. 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.

Certain reclassifications have been made to the 2010 consolidated condensed statements of cash flows to conform to the 2011 presentation.

**Note 2 Additional Financial Information Disclosures**

The consolidated condensed balance sheet at December 31, 2010 was derived from amounts included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. 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. The following table presents changes in the Company's warranty and after-sale costs reserve for the three- and nine-month periods ended September 30, 2011 and 2010.

(In thousands)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Balance at beginning of period	\$ 932	\$ 1,143	\$ 889	\$ 907
Net additions charged to earnings	272	243	748	671
Costs incurred and adjustments	(200)	(328)	(633)	(520)
Balance at end of period	\$ 1,004	\$ 1,058	\$ 1,004	\$ 1,058

**Note 3 Employee Benefit Plans**

Prior to 2011, the Company maintained a non-contributory defined benefit pension plan that covered substantially all of its employees in the United States. As of January 1, 2011, the Company froze its pension plan for its non-union participants and formed a new feature within the Badger Meter Employee Savings and Stock Ownership Plan (ESSOP) in which each employee receives a similar benefit. No new benefits will accrue in the pension plan for the non-union participants, although they will continue to accrue interest on prior balances. 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.



**Table of Contents**

The following table sets forth the components of net periodic benefit cost for the three months ended September 30, 2011 and 2010 based on December 31, 2010 and 2009 actuarial measurement dates, respectively:

(In thousands)	Defined pension plan benefits		Other postretirement benefits	
	2011	2010	2011	2010
Service cost benefits earned during the year	\$ 107	\$ 447	\$ 37	\$ 32
Interest cost on projected benefit obligations	605	496	81	81
Expected return on plan assets	(936)	(864)	0	0
Amortization of prior service cost	49	50	40	42
Amortization of net loss	448	437	0	0
Net periodic benefit cost	\$ 273	\$ 566	\$ 158	\$ 155

The following table sets forth the components of net periodic benefit cost for the nine months ended September 30, 2011 and 2010 based on December 31, 2010 and 2009 actuarial measurement dates, respectively:

(In thousands)	Defined pension plan benefits		Other postretirement benefits	
	2011	2010	2011	2010
Service cost benefits earned during the year	\$ 393	\$ 1,393	\$ 111	\$ 104
Interest cost on projected benefit obligations	1,859	1,855	243	254
Expected return on plan assets	(2,825)	(2,767)	0	0
Amortization of prior service cost	147	50	120	124
Amortization of net loss	1,346	1,217	0	0
Net periodic benefit cost	\$ 920	\$ 1,748	\$ 474	\$ 482

The Company previously disclosed in its financial statements for the year ended December 31, 2010 that it did not expect to make a contribution to its pension plan for the 2011 calendar year. The Company has determined that no additional contribution will be required for 2011, although it may consider voluntary payments to the plan.

The Company disclosed in its financial statements for the year ended December 31, 2010 that it estimated it would pay \$0.5 million in other postretirement benefits in 2011 based on actuarial estimates. As of September 30, 2011, \$0.3 million of such benefits were paid. The Company believes that its estimated payments for the full year may be slightly 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 retirees' portion of certain costs. Note that the amount of benefits paid in calendar year 2011 will not impact the expense for postretirement benefits for 2011.

**Note 4 Comprehensive Income (Loss)**

Comprehensive income for the three-month periods ended September 30, 2011 and 2010 was \$6.5 million and \$10.2 million, respectively. Comprehensive income for the nine-month periods ended September 30, 2011 and 2010 was \$19.4 million and \$23.1 million, respectively.

Components of accumulated other comprehensive loss are as follows:

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(In thousands)	September 30, 2011	December 31, 2010
Cumulative foreign currency translation adjustment	\$ 1,805	\$ 1,457
Unrecognized pension and postretirement benefit plan liabilities net of tax	(13,532)	(14,594)
Accumulated other comprehensive loss	\$ (11,727)	\$ (13,137)

## **Table of Contents**

### **Note 5 Acquisition**

On January 26, 2011, the Company purchased Remag, AG ( Remag ) of Berne, 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 specialty application products. The Company finalized its allocation of the purchase price as of September 30, 2011 which includes \$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, and other assets and liabilities.

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. 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 and is in the process of resolving a claim related 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. Regarding the landfill sites, 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 2010 and the first three quarters of 2011 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 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 an AMR 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.

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.

## **Table of Contents**

### **Note 7 Income Taxes**

The provision for income taxes as a percentage of earnings before income taxes for the third quarter of 2011 was 14.8% compared to 32.4% in the third quarter of 2010. The provision for income taxes as a percentage of earnings before income taxes for the nine-month period ended September 30, 2011 was 29.2% compared to 35.8% in the same period in 2010. The third quarter of 2011 results included recognition of previously unrecognized tax benefits for certain deductions that were taken on prior tax returns. These benefits total \$1.5 million and were recognized in earnings in the third quarter due to the realization that such benefits became more likely than not upon the conclusion of an IRS audit of the Company's 2009 federal income tax return. Without these benefits, the provision for income taxes as a percentage of earnings before income taxes would have been 33.1% and 35.0% for the three- and nine-month periods ended September 30, 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.

In October 2011, the Company renewed its principal line of credit (increasing it from \$50.0 million to \$65.0 million) for one year. 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 had \$58.9 million of unused credit lines available at September 30, 2011.

In October 2011, the Milwaukee union employees voted to accept changes in their contract with the Company effective November 1, 2011. Included in these changes was an agreement to freeze their current defined benefit pension and replace it with a defined contribution plan. This will result in a curtailment charge under ASC 715 Retirement Benefits Compensation, which the Company currently estimates to be approximately \$1.0 million.

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

### **Business Description and Overview**

Badger Meter's core competency is flow measurement solutions. The Company is a leading manufacturer and marketer of products incorporating liquid flow measurement and control technologies developed both internally and with other technology companies. Its products are used in a variety of applications, including water, oil and chemicals. The Company's product lines fall into two categories: water applications and specialty applications.

Water applications, the largest category by sales volume, include 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. The Company's products are also sold for other water-based purposes including irrigation, water reclamation and industrial process applications.





## **Table of Contents**

Specialty applications include the sale of 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. It also includes the sale of radio technology to natural gas utilities for installation on their gas meters.

Sales of water meters and related technologies and services for water applications constitute a majority of the Company's sales and are commonly referred to as residential or commercial meter sales, the latter referring to larger sizes of meters.

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. Drive-by 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 and they have the ability to provide the utility with more frequent and diverse data from the utility's meters at specified intervals.

In early 2011, the Company introduced what it believes will be the next generation of metering technology, advanced metering analytics (AMA), that incorporates both drive-by and fixed network reading capabilities, along with a host of automated utility management tools to facilitate the ability of water utilities to increase their productivity and revenue. 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 meters.

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 technology and the GALAXY® AMI system, the Company also remarkets the Itron® AMR 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, along with the adoption and deployment of new technology, comprise the majority of water meter product sales, including AMR/AMI 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.

The specialty application 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. This product group also includes sales of the ORION radio technology to natural gas utilities for installation on their meters.

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## **Table of Contents**

### **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. Specifically, AMI enables water utilities to capture readings from each meter at specific intervals.

In early 2011, the Company introduced what it believes will be the next generation of metering technology, AMA, that incorporates both drive-by and fixed network reading capabilities, along with a host of automated utility management tools to facilitate the ability of water utilities to increase their productivity and revenue. 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 meters. 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. A limited rollout of the Company's AMA products was done in the first half of 2011 and these products became fully available in the third quarter of 2011.

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 communication by water utilities, the vast majority of utilities installing AMR or AMI 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, 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 26, 2011, the Company purchased Remag, AG of Berne, 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 specialty application products. The Company finalized its allocation of the purchase price as of September 30, 2011 which includes \$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, and other assets and liabilities.

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. The acquisition did not have a material impact on the Company's consolidated financial statements or the notes thereto.

### **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 2.7 times greater than those of the Itron licensed products for the first three quarters of 2011 and 2.2 times greater for all of 2010, the Company expects that the Itron products will remain a significant component of sales to 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.

As the industry continues to evolve, the Company has been vigilant in anticipating and exceeding customer expectations. In early 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

**Table of Contents**

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 September 30, 2011**

The Company's net sales for the three months ended September 30, 2011 decreased \$6.0 million, or 7.9%, to \$69.7 million compared to \$75.7 million during the same period in 2010. The decrease was due to lower sales of water application products, offset in part by higher sales of specialty application products. Also included in the third quarter of 2011 results were approximately \$0.9 million of specialty application product sales related to the acquisition of Remag that were not included in the prior year amounts.

Water application products represented 81.6% of sales for the three months ended September 30, 2011 compared to 83.7% in the same period in 2010. These sales declined nearly \$6.5 million for the three months ended September 30, 2011, or 10.3%, to \$56.9 million from \$63.4 million during the same period in 2010. The decline was due primarily to lower volumes of the Company's AMR/AMI related products, as well as lower sales of commercial meters and manual read residential meters. Sales of the Company's ORION AMR technology products decreased 6.5%, while sales of the Itron related products declined 44.2%. (Itron sales were substantially higher last year due to increased sales to certain customers.) In the most recent period, ORION related products outsold Itron related products by a ratio of 3 to 1. Commercial meter sales declined 5.2% in this period over the same period in 2010, while manual residential meters sales were down 25.2%. These declines were offset somewhat by higher sales of Galaxy fixed network related products. The Company believes the net overall volume declines were due to a continuation of certain factors, including concerns over municipal spending that delayed 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.

Specialty application products represented 18.4% of sales for the three months ended September 30, 2011 compared to 16.3% for the same period in 2010. These sales increased \$0.5 million in the third quarter of 2011, or 4.1%, to \$12.8 million from \$12.3 million during the same period in 2010. The increase in sales was due to the addition of \$0.9 million for the acquisition of Remag which was not in the 2010 amounts, as well as increases in most of the specialty application product lines, offset by lower sales of radio technology to natural gas customers.

Gross margins were impacted by the net overall sales decrease during the third quarter of 2011. The gross margin as a percentage of sales was 32.7% in the third quarter of 2011 compared to 36.9% in the third quarter of 2010. The decrease was due to lower volumes of products sold which affects allocations of certain fixed costs, plus higher costs of product sourced in Europe due to foreign exchange effects and the higher copper costs, offset somewhat by higher prices charged for products sold and the labor savings as a result of moving production to Mexico.

Selling, engineering and administration expenses increased \$0.3 million, or 1.9%, over the same period in 2010. The increase was primarily attributable to the acquisition of Remag, which was not included in the results for the third quarter of 2010, as well as lower employee incentives due to lower financial results.

Interest expense for the quarter ended September 30, 2011 was a credit balance because \$0.1 million of interest expense was reversed for amounts previously accrued for the tax issues discussed below.

Operating earnings declined \$5.4 million, or 40.3%, to \$8.0 million compared to \$13.4 million in 2010, due primarily to the lower sales and corresponding impact on gross margin.

The provision for income taxes as a percentage of earnings before income taxes for the third quarter of 2011 was 14.8% compared to 32.4% in the third quarter of 2010. The current quarter results include recognition of previously unrecognized tax benefits for certain deductions that were taken on prior tax returns. These benefits total \$1.5 million and were recognized in earnings in the current quarter due to the realization that such benefits became more likely than not upon the conclusion of an Internal Revenue Service (IRS) audit of the Company's 2009 federal income tax return. Without these benefits, the provision for income taxes as a percentage of earnings before income taxes would have been 33.1%. The provision in the third quarter of 2010 reflected revisions in the annual estimate.

**Table of Contents**

As a result of the above mentioned items, net earnings for the three months ended September 30, 2011 were \$6.9 million, or \$0.46 per diluted share, compared to \$9.0 million, or \$0.60 per diluted share, for the same period in 2010.

**Results of Operations Nine Months Ended September 30, 2011**

The Company's net sales for the nine months ended September 30, 2011 decreased \$9.6 million, or 4.5%, to \$202.2 million from \$211.8 million in the same period in 2010. The net decrease was due to lower sales of water application products offset by higher sales of specialty application products and higher product prices.

Water application products represented 77.9% of sales for the nine months ended September 30, 2011 compared to 85.5% for the same period in 2010. These sales decreased \$23.5 million, or 13.0%, to \$157.6 million compared to \$181.1 million in the same period in 2010. The decline was due primarily to lower volumes of the Company's AMR/AMI related products, as well as lower sales of commercial meters and manual read residential meters. Sales of the Company's ORION AMR technology products decreased 19.9% in the first nine months of 2011 from the same period in 2010, while sales of the Itron related products decreased 27.2%. In the first nine months of 2011, Orion related products outsold Itron related products by a ratio of 2.7 to 1. Commercial sales decreased 19.3% in the first nine months of 2011 over the same period in 2010. The Company believes the volume declines were due to certain factors, including general purchasing reductions due to the economic downturn, concerns over municipal spending that delayed 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. In addition, poor weather in the Midwest and Northeast had a negative impact on sales due to its effects on budgets and installation rates early in the year.

Specialty products represented 22.1% of sales for the nine-month period ended September 30, 2011 compared to 14.5% for the same period in 2010. These sales increased nearly \$14.0 million, or 45.3%, to \$44.6 million for the first nine months of 2011 from \$30.7 million for the first nine months of 2010. The increase in sales included \$2.5 million for Remag, which was acquired in early 2011. Sales also include \$6.2 million for Cox Flow Measurement (Cox) sales for the first nine months of 2011 versus \$2.9 million in 2010, representing sales from its acquisition date of April 1, 2010 through September 30, 2010. The remainder of the increase was due primarily to increased sales of radio technology to natural gas customers for connection to their gas meters and higher sales of valves, both domestically and internationally.

Gross margin as a percentage of net sales was 34.8% for the first nine months of 2011 compared to 36.9% in the same period in 2010. The decline was due to lower than anticipated volumes and increased costs of materials, particularly for castings whose costs fluctuate with the metals market, offset by higher selling prices and continuing efforts to reduce manufacturing costs. In addition, the increase in specialty product sales had a positive impact on margins.

Selling, engineering and administration expenses increased \$1.9 million, or 4.4%, in the nine-month period ended September 30, 2011 compared to the same period in 2010. The increase was due in part to higher expenses associated with the Cox acquisition of which only six months were in the first nine months of 2010, as well as the addition of Remag in 2011. The increase was also due to higher amortization of various intangibles and software and higher costs associated with technical support for the Company's products. These increases were somewhat offset by lower employee incentives. The 2010 amounts included a one-time credit of \$0.7 million for the fair value of land received in settlement of claims against a building contractor.

Operating earnings declined \$9.7 million, or 27.6%, to \$25.5 million compared to \$35.2 million in 2010 as a result of the lower sales and higher costs.

The provision for income taxes as a percentage of earnings before income taxes for the nine-month period ended September 30, 2011 was 29.2% compared to 35.8% in the same period in 2010. The current year-to-date results include recognition of previously unrecognized tax benefits for certain deductions that were taken on prior tax returns. These benefits total nearly \$1.5 million and were recognized in earnings in the current quarter due to the realization that such benefits became more likely than not upon the conclusion of an IRS audit of the Company's 2009 federal income tax return. Without these benefits, the provision for income taxes as a percentage of earnings before income taxes would have been 35.0%.

As a result of the above mentioned items, net earnings for the nine months ended September 30, 2011 were \$18.0 million compared to \$22.4 million in the nine-month period ended September 30, 2010. On a diluted basis, earnings per share were \$1.19 for the first nine months of 2011 compared to \$1.49 for the same period in 2010.

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## **Table of Contents**

### **Liquidity and Capital Resources**

The main sources of liquidity for the Company are cash from operations and borrowing capacity. Cash provided by operations was \$26.3 million for the first nine months of 2011 compared to \$13.7 million in the same period in 2010. The cash impact of lower earnings for the first nine months of 2011 was more than offset by lower working capital than in 2010.

The receivable balance increased from \$40.4 million at December 31, 2010 to \$43.2 million at September 30, 2011 due principally to the seasonality of business. Generally, sales are the lowest in the fourth quarter resulting in lower receivable balances at year end. The Company believes its net receivables balance is fully collectible.

Inventories at September 30, 2011 decreased \$0.5 million to \$47.8 million from \$48.3 million at December 31, 2010. The decrease was the net effect of higher sales which reduced balances, offset by higher material costs, particularly for castings of which copper is a main component, and increased lead times for electronics resulting in higher safety stock levels.

Prepaid expenses and other current assets at September 30, 2011 increased to \$3.0 million from \$2.4 million at December 31, 2010 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 September 30, 2011 increased to \$66.4 million from \$66.1 million at December 31, 2010 due to the purchase of Remag and normal capital expenditures, partially offset by depreciation expense.

Other assets decreased \$1.0 million to \$6.4 million at September 30, 2011 from \$7.4 million at December 31, 2010 due to the conversion of cash surrender values on certain insurance policies into cash.

The increase in intangibles to \$34.3 million at September 30, 2011 from \$34.2 million at December 31, 2010 was due to the acquisition of Remag, offset slightly by normal amortization.

Short-term debt decreased from \$12.9 million at December 31, 2010 to \$2.7 million at September 30, 2011. The decrease was due to the increased cash provided from operations, offset somewhat by funds used for the acquisition of Remag.

Accounts payable increased to \$13.9 million at September 30, 2011 from \$11.2 million at December 31, 2010 due primarily to the timing of payments.

Accrued income and other taxes increased to \$1.5 million at September 30, 2011 from \$0.6 million at December 31, 2010 due to current year accruals for taxes and the timing of income tax payments.

Other long term liabilities decreased \$1.6 million to \$0.9 million at September 30, 2011 from \$2.5 million at December 31, 2010 due to the reversal of reserves associated with unrecognized tax benefits.

The Company believes its financial condition remains strong and 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 had \$58.9 million of available short-term credit lines at September 30, 2011.

### **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 and is in the process of resolving a claim related 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



## **Table of Contents**

perspective or on the financial statements as a whole. Regarding the landfill sites, 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 2010 and the first three quarters of 2011 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 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 an AMR 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, 2010 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, 2010 and have not materially changed since that report was filed.

### **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, 2010 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 September 30, 2011. 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.





**Table of Contents**

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 September 30, 2011 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II Other Information**

**Item 6 Exhibits**

<b>Exhibit No.</b>	<b>Description</b>
4.1	Loan Agreement dated October 30, 2011 between Badger Meter, Inc. and BMO Harris Bank relating to Badger Meter, Inc.'s revolving credit loan.
4.2	Loan Agreement dated October 30, 2011 between Badger Meter, Inc. and BMO Harris Bank relating to Badger Meter, Inc.'s euro note.
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 September 30, 2011 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 Cash Flows and (iv) Notes to Unaudited Consolidated Condensed Financial Statements, tagged as blocks of text.

**Table of Contents**

**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: October 26, 2011

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

**Table of Contents**

**BADGER METER, INC.**

**Quarterly Report on Form 10-Q for the Period Ended September 30, 2011**

**Exhibit Index**

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