

BADGER METER INC  
Form 10-Q  
April 23, 2014  
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
for the quarterly period ended March 31, 2014

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BADGER METER, INC.

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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

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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 April 9, 2014, there were 14,440,419 shares of Common stock outstanding with a par value of \$1 per share.

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Special Note Regarding Forward Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q, as well as other information provided from time to time by Badger Meter, Inc. (the "Company") or its employees, may contain forward looking statements that involve risks and uncertainties that could cause actual results to differ materially from those in the forward looking statements. The words "anticipate," "believe," "estimate," "expect," "think," "should," "could" and "objective" or similar expressions are used to identify forward looking statements. All such forward looking statements are based on the Company's then current views and assumptions and involve risks and uncertainties. Some risks and uncertainties that could cause actual results to differ materially from those expressed or implied in forward looking statements include those described in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 that include, among other things:

- the continued shift in the Company's business from lower cost, manually read meters toward more expensive, value-added automatic meter reading (AMR) systems, advanced metering infrastructure (AMI) systems and advanced metering analytics (AMA) systems that offer more comprehensive solutions to customers' metering needs;
- the success or failure of newer Company products;
- changes in competitive pricing and bids in both the domestic and foreign marketplaces, and particularly in continued intense price competition on government bid contracts for lower cost, manually read meters;
- the actions (or lack thereof) of the Company's competitors;
- changes in the Company's relationships with its alliance partners, primarily its alliance partners that provide radio 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;
- unusual weather and other natural phenomena, including related economic and other ancillary effects of any such events;
- the timing and impact of government programs to stimulate national and global economies, as well as the impact of government budget cuts or partial shutdowns of governmental operations;
- 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 connectivity 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;
- changes in foreign economic conditions, particularly currency fluctuations in the United States dollar, the Euro and the Mexican peso;
- the failure of the Company's technology products to operate as intended;
- the inability to protect the Company's proprietary rights to its software and related products;
- the loss of certain single-source suppliers; and
- changes in laws and regulations, particularly laws dealing with the use of lead (which can be used in the manufacture of certain meters incorporating brass housings) and the United States Federal Communications Commission rules affecting the use and/or licensing of radio frequencies necessary for radio products.

All of these factors are beyond the Company's control to varying degrees. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward looking statements contained in this

Quarterly Report on Form 10-Q and are cautioned not to place undue reliance on such forward looking statements. The forward looking statements made in this document are made only as of the date of this document and the Company assumes no obligation, and disclaims any obligation, to update any such forward looking statements to reflect subsequent events or circumstances.

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## Part I – Financial Information

## Item 1 Financial Statements

## BADGER METER, INC.

## Consolidated Condensed Balance Sheets

	March 31, (Unaudited) (In thousands) 2014	December 31, 2013
Assets		
Current assets:		
Cash	\$6,408	\$7,263
Receivables	54,658	50,133
Inventories:		
Finished goods	18,113	17,704
Work in process	11,678	12,330
Raw materials	34,187	30,905
Total inventories	63,978	60,939
Prepaid expenses and other current assets	3,354	3,994
Deferred income taxes	4,900	4,834
Total current assets	133,298	127,163
Property, plant and equipment, at cost	167,537	164,138
Less accumulated depreciation	(90,236	) (87,722
Net property, plant and equipment	77,301	76,416
Intangible assets, at cost less accumulated amortization	56,058	57,317
Prepaid pension	4,540	4,312
Other assets	7,786	6,155
Goodwill	44,695	44,695
Total assets	\$323,678	\$316,058
Liabilities and shareholders' equity		
Current liabilities:		
Short-term debt	\$73,869	\$70,045
Payables	17,433	18,554
Accrued compensation and employee benefits	7,184	7,337
Warranty and after-sale costs	1,199	882
Income and other taxes	3,072	1,223
Total current liabilities	102,757	98,041
Other long-term liabilities	1,335	1,324
Deferred income taxes	9,798	9,790
Accrued non-pension postretirement benefits	5,918	5,934
Other accrued employee benefits	4,067	4,406
Commitments and contingencies (Note 6)		
Shareholders' equity:		
Common stock	20,518	20,504
Capital in excess of par value	46,339	45,627
Reinvested earnings	172,371	170,318
Accumulated other comprehensive loss	(7,263	) (7,524

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Less: Employee benefit stock	(995	) (1,075	)
Treasury stock, at cost	(31,167	) (31,287	)
Total shareholders' equity	199,803	196,563	
Total liabilities and shareholders' equity	\$323,678	\$316,058	

See accompanying notes to unaudited consolidated condensed financial statements.

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## BADGER METER, INC.

## Consolidated Statements of Operations

	Three Months Ended March 31, (Unaudited) (Dollars in thousands except share and per share amounts)	
	2014	2013
Net sales	\$83,496	\$71,808
Cost of sales	54,545	46,771
Gross margin	28,951	25,037
Selling, engineering and administration	21,261	20,312
Operating earnings	7,690	4,725
Interest expense, net	291	248
Earnings before income taxes	7,399	4,477
Provision for income taxes	2,767	1,570
Net earnings	\$4,632	\$2,907
Earnings per share:		
Basic	\$0.33	\$0.21
Diluted	\$0.32	\$0.20
Dividends declared per common share	\$0.18	\$0.17
Shares used in computation of earnings per share:		
Basic	14,240,220	14,145,406
Impact of dilutive securities	89,977	91,351
Diluted	14,330,197	14,236,757
See accompanying notes to unaudited consolidated condensed financial statements.		

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BADGER METER, INC.

Consolidated Statements of Comprehensive Income

	Three Months Ended March 31, (Unaudited) (In thousands)	
	2014	2013
Net earnings	\$4,632	\$2,907
Other comprehensive income (loss):		
Foreign currency translation adjustment	140	(521 )
Employee benefit funded status adjustment, net of tax	121	162
Comprehensive income	\$4,893	\$2,548
See accompanying notes to unaudited consolidated condensed financial statements.		



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## BADGER METER, INC.

## Consolidated Condensed Statements of Cash Flows

	Three Months Ended March 31 (Unaudited) (In thousands)	
	2014	2013
Operating activities:		
Net earnings	\$4,632	\$2,907
Adjustments to reconcile net earnings to net cash provided by (used for) operations:		
Depreciation	2,474	2,191
Amortization	1,274	1,164
Deferred income taxes	(66)	) (24)
Noncurrent employee benefits	(113)	) 255
Stock-based compensation expense	363	273
Changes in:		
Receivables	(4,772)	) (1,838)
Inventories	(2,998)	) 2,445
Prepaid expenses and other current assets	646	416
Liabilities other than debt	(859)	) (3,481)
Total adjustments	(4,051)	) 1,401
Net cash provided by operations	581	4,308
Investing activities:		
Property, plant and equipment expenditures	(3,328)	) (2,803)
Net cash used for investing activities	(3,328)	) (2,803)
Financing activities:		
Net increase (decrease) in short-term debt	3,784	(2,750)
Dividends paid	(2,580)	) (2,421)
Proceeds from exercise of stock options	417	620
Tax benefit on stock options	145	363
Issuance of treasury stock	66	147
Net cash provided by (used for) financing activities	1,832	(4,041)
Effect of foreign exchange rates on cash	60	(231)
Decrease in cash	(855)	) (2,767)
Cash – beginning of period	7,263	6,554
Cash – end of period	\$6,408	\$3,787
See accompanying notes to unaudited 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 March 31, 2014, results of operations for the three-month periods ended March 31, 2014 and 2013, comprehensive income for the three-month periods ended March 31, 2014 and 2013, and cash flows for the three-month periods ended March 31, 2014 and 2013. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

## Note 2 Additional Financial Information Disclosures

The consolidated condensed balance sheet at December 31, 2013 was derived from amounts included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. 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 are as follows:

(In thousands)	Three months ended	
	March 31,	
	2014	2013
Balance at beginning of period	\$882	\$881
Net additions charged to earnings	586	200
Costs incurred	(269	) (364
Balance at end of period	\$1,199	\$717

## Note 3 Employee Benefit Plans

The Company maintains a non-contributory defined benefit pension plan (sometimes referred to as the "qualified pension plan") for certain employees. After December 31, 2011, employees received no future benefits under the qualified pension plan as benefits were frozen and the employees now receive a defined contribution within the Badger Meter Employee Savings and Stock Ownership Plan ("ESSOP") in its place. Employees continue to earn returns on their frozen balances under the qualified pension plan. The Company also maintains a non-contributory postretirement plan that provides medical benefits for certain of its retirees and eligible dependents in the United

States.

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The following table sets forth the components of net periodic benefit cost (income) for the three months ended March 31, 2014 and 2013 based on December 31, 2013 and 2012 actuarial measurement dates, respectively:

(In thousands)	Defined pension plan benefits		Other postretirement benefits	
	2014	2013	2014	2013
Service cost – benefits earned during the year	\$7	\$13	\$36	\$42
Interest cost on projected benefit obligations	494	452	73	66
Expected return on plan assets	(713	) (695	) —	—
Amortization of prior service cost	—	—	40	40
Amortization of net loss	153	215	—	3
Net periodic benefit cost (income)	\$(59	) \$(15	) \$149	\$151

The Company disclosed in its financial statements for the year ended December 31, 2013 that it was not required to make a minimum contribution to the defined benefit pension plan for the 2014 calendar year. The Company continues to believe no additional contributions will be required during 2014.

The Company also disclosed in its financial statements for the year ended December 31, 2013 that it estimated it would pay \$0.5 million in other postretirement benefits in 2014 based on actuarial estimates. As of March 31, 2014, \$0.1 million of such benefits have been paid. The Company continues to believe that its estimated payments for the full year are reasonable. However, such estimates contain inherent uncertainties because cash payments can vary significantly depending on the timing of postretirement medical claims and the collection of the retirees' portion of certain costs. Note that the amount of benefits paid in calendar year 2014 will not impact the expense for postretirement benefits for 2014.

## Note 4 Accumulated Other Comprehensive Loss

Components of and changes in accumulated other comprehensive loss at March 31, 2014 are as follows:

(In thousands)	Unrecognized pension and postretirement benefits	Foreign currency	Total
Balance at beginning of period	\$(9,280	) \$1,756	\$(7,524
Other comprehensive income before reclassification	—	140	140
Amounts reclassified from accumulated other comprehensive loss, net of tax of \$(0.1) million	121	—	121
Net current period other comprehensive income, net of tax	121	140	261
Accumulated other comprehensive (loss) income	\$(9,159	) \$1,896	\$(7,263

Details of reclassifications out of accumulated other comprehensive loss during the three months ended March 31, 2014 are as follows:

(In thousands)	Amount reclassified from accumulated other comprehensive loss

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Amortization of defined benefit pension items:

Prior service cost (1)	\$40	
Amortization of actuarial loss (1)	153	
Total before tax	193	
Income tax benefit	(72	)
Amount reclassified out of accumulated other comprehensive loss	\$121	

(1) These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost (income) in Note 3 "Employee Benefit Plans."

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Components of and changes in accumulated other comprehensive loss at March 31, 2013 are as follows:

(In thousands)	Unrecognized pension and postretirement benefits	Foreign currency	Total
Balance at beginning of period	\$(15,532	) \$1,584	\$(13,948 )
Other comprehensive income before reclassification	—	(521	) (521 )
Amounts reclassified from accumulated other comprehensive loss, net of tax of \$(0.1) million	162	—	162
Net current period other comprehensive income, net of tax	162	(521	) (359 )
Accumulated other comprehensive (loss) income	\$(15,370	) \$1,063	\$(14,307 )

Details of reclassifications out of accumulated other comprehensive loss during the three months ended March 31, 2013 are as follows:

(In thousands)	Amount reclassified from accumulated other comprehensive loss
Amortization of defined benefit pension items:	
Prior service cost (1)	40
Amortization of actuarial loss (1)	218
Total before tax	258
Income tax benefit	(96 )
Amount reclassified out of accumulated other comprehensive loss	\$162

(1) These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost (income) in Note 3 "Employee Benefit Plans."

#### Note 5 Acquisitions

On April 1, 2013, the Company acquired 100% of the outstanding common stock of Aquacue, Inc. ("Aquacue") of Los Gatos, California. The Aquacue acquisition provides the Company with intellectual property that complements and expands the Company's advanced metering analytics offerings by adding an integrated software platform that allows utility managers to monitor and control their water systems, while providing water management data to consumers.

The purchase price was \$13.8 million in cash, including a small working capital adjustment. The purchase price included a final \$3.0 million payment, of which half was due January 10, 2014 and half is due October 10, 2014, and these amounts were recorded in payables on the Consolidated Balance Sheets at December 31, 2013. As of December 31, 2013, the Company completed its analysis for estimating the fair value of the assets acquired and liabilities assumed, and merged Aquacue into Badger Meter, Inc.

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 condensed financial statements or the notes thereto for 2013.

Note 6 Contingencies, Litigation and Commitments

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

The Company is subject to contingencies related to environmental laws and regulations. The Company is named as one of many potentially responsible parties in two landfill lawsuits. The landfill sites are impacted by the Federal Comprehensive Environmental Response, Compensation and Liability Act and other environmental laws and regulations. At this time, the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the

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Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. This belief is based on the Company's assessment of its limited past involvement with these landfill sites as well as the substantial involvement of and government focus on other named third parties with these landfill sites. However, due to the inherent uncertainties of such proceedings, the Company cannot predict the ultimate outcome of any of these matters. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2013 and the first quarter of 2014 were not material.

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

The Company relies on single suppliers for most brass castings and certain electronic subassemblies in several of its product lines. The Company believes these items would be available from other sources, but that the loss of certain suppliers would result in a higher cost of materials, delivery delays, short-term increases in inventory and higher quality control costs 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 exposures on a periodic basis and makes adjustments to reserves as appropriate.

### Note 7 Income Taxes

The provision for income taxes as a percentage of earnings before income taxes for the first quarter of 2014 was 37.4% compared to 35.1% in the first quarter of 2013. The increase for the first three months of 2014 was due primarily to the recognition in the first quarter of 2013 of 2012 research and development credits identified in the first quarter of 2013. Without such recognition, the tax rates for the first quarter of 2014 and 2013 would have been similar. Generally, the effective tax rate is higher than the Federal statutory rate due to state income taxes, mitigated somewhat by manufacturing credits.

### Note 8 Fair Value Measurements of Financial Instruments

The Company applies the accounting standards for fair value measurements and disclosures for its financial assets and financial liabilities. The carrying amounts of cash, receivables and payables in the financial statements approximate their fair values due to the short-term nature of these financial instruments. Short-term debt is comprised of notes payable drawn against the Company's lines of credit and commercial paper. Because of its short-term nature, the carrying amount of the short-term debt also approximates fair value. Included in other assets are insurance policies on various individuals who were associated with the Company. The carrying amounts of these insurance policies approximate their fair value.

### Note 9 Subsequent Events



The Company evaluates subsequent events at the date of the balance sheet as well as conditions that arise after the balance sheet date but before the financial statements are 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, if any, disclosures are made regarding the nature of events and the estimated financial effects for those 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.

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

Business Description and Overview

An innovator in flow measurement and control products, the Company serves water utilities, municipalities, and commercial and industrial customers worldwide. Measuring water, oil, chemicals and other fluids, the Company's products are known for accuracy, long-lasting durability and for providing valuable and timely measurement data. The Company's product lines fall into three categories: sales of water meters and related technologies to municipal water utilities (municipal water), sales of meters to various industries for water and other fluids (flow instrumentation), and sales of gas meter radios and concrete vibrators to unique markets (specialty products). The Company estimates that over 75% of its products are used in water applications when all categories are grouped together.

Municipal water, the largest category by sales volume, includes mechanical and electronic (static) 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 most meters are designed and manufactured to conform to standards promulgated by the American Water Works Association. Sales of water meters and related technologies and services are commonly referred to as residential or commercial water meter sales, the latter referring to larger sizes of meters.

Flow instrumentation includes products sold worldwide to measure and control materials flowing through a pipe or pipeline including water, air, steam, oil, and other liquids and gases. These meters and valves are used in a variety of applications, such as water/wastewater; heating, ventilating and air conditioning (HVAC); oil and gas; chemical and petrochemical; food and beverage; and pharmaceutical production.

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

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 a water meter and a register that gives a visual meter reading display. Meters equipped with radio transmitters (endpoints) use encoder registers to convert the measurement data from the meter into an encrypted digital format which is then transmitted via radio frequency to a receiver that collects and formats the data appropriately for water utility billing systems. Mobile systems, referred to as automatic meter reading (AMR) systems, have been the primary technology deployed by water utilities over the past two decades, providing accurate and cost-effective billing data. In an AMR system, a vehicle equipped for meter reading purposes, including a radio receiver, computer and reading software, collects the data from utilities' 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 utilities' meters. AMI systems eliminate the need for utility personnel to drive through service territories to collect meter reading data. These systems provide the utilities with more frequent and diverse data from the utilities' meters at specified intervals.

In 2011, the Company introduced what it believes is the next generation of metering technology, advanced metering analytics (AMA), along with a host of automated utility management tools to facilitate the ability of water and gas utilities to increase their productivity and revenue, as well as proactively utilize their data. AMA is comprised of ReadCenter® Analytics software coupled with ORION® SE two-way fixed network or GALAXY® one-way fixed network technology, which is complemented by a family of highly accurate and reliable water meters.

The ORION SE system can operate in either a mobile or fixed network mode depending on the deployment needs of the utility. For example, a water or gas utility can begin deployment in mobile mode and transition to a fixed network system without visiting the endpoint. Once deployed, if the system is operating in fixed network mode and the gateway data collector stops functioning, the endpoint will continue to send data that can be captured by a mobile system. Once the gateway data collector functions again, the utility will again receive data through the fixed network system.

In January 2014, the Company launched its new BEACON AMA system. BEACON AMA combines the BEACON analytical software suite with proven ORION AMI technology using fixed and cellular networks in a managed solution, improving utilities' visibility of their water consumption and reducing the need for costly infrastructure. With the release of BEACON AMA, Badger Meter also became the first major worldwide water meter company to release a cost-effective cellular-

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based solution for system wide deployment. BEACON AMA enables two-way communication between the water meter and the meter reading system.

The BEACON AMA secure, hosted software suite includes a customizable dashboard, the ability to establish alerts for specific conditions, and consumer engagement tools that allow end water customers to view and manage their water usage activity. Benefits to the utility include faster leak detection, easier revenue management, the ability to quantify the effects of its water conservation efforts, easier compliance reporting, and improved customer service.

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 radio technology. In addition to selling its proprietary radio products, including the ORION radio technologies and GALAXY AMI/AMA system, the Company also remarkets the Itron® radio products under a license and distribution agreement with Itron. The Company's proprietary radio products generally result in higher margins than the remarketed, non-proprietary technology products. The Company also sells registers and endpoints separately to customers who wish to upgrade their existing meters in the field.

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

Water meter replacement and the adoption and deployment of new technology comprise the majority of water meter product sales, including radio 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 radio technology. This conversion rate is accelerating and contributes to an increased water meter and radio solutions base of business. The Company estimates that less than 43% of water meters installed in the United States have been converted to a radio solutions 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.

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

## Business Trends

Increasingly, the electric utility industry relies on AMI technology for two-way communication to monitor and control electrical devices at the customer's site. Although the Company does not sell products for electric market applications, the trend toward AMI affects the markets in which the Company does participate, particularly for those customers in the water utility market that are interested in more frequent and diverse data collection. Specifically, AMI and AMA technologies enable water utilities to capture readings from each meter at more frequent and variable intervals. Similar to the electric utility industry a few years ago, the water utility industry is beginning to see the adoption of electronic (static) water meters. Electronic water metering has lower barriers to entry which could affect the competitive landscape in North America.

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 43% of them have converted to a radio solutions technology. Although there is growing interest in AMI and AMA communication by water utilities, the vast majority of utilities installing such technology continue to select AMR technologies for their applications. The Company's ORION technology has experienced rapid acceptance in the United States as an increasing number of water utilities have selected ORION as their AMR solution. The Company anticipates that even with growing interest in AMI and AMA, AMR will continue to be the primary product of choice for a number of years. For many water utilities, AMR technology is simply the most cost-effective solution available today. However, with the introduction of its newer product offerings, including the recently introduced BEACON AMA system, the Company believes it is well-positioned to meet customers' future needs.

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### Acquisition

On April 1, 2013, the Company acquired 100% of the outstanding common stock of Aquacue, Inc. (“Aquacue”) of Los Gatos, California. The Aquacue acquisition provides the Company with intellectual property that complements and expands the Company’s advanced metering analytics offerings by adding an integrated software platform that allows utility managers to monitor and control their water systems, while providing water management data to consumers.

The purchase price was \$13.8 million in cash, including a small working capital adjustment. The purchase price included a final \$3.0 million payment, of which half was due January 10, 2014 and half is due October 10, 2014, and these amounts were recorded in payables on the Consolidated Balance Sheets at December 31, 2013. As of December 31, 2013, the Company completed its analysis for estimating the fair value of the assets acquired and liabilities assumed, and merged Aquacue into Badger Meter, Inc. This acquisition is further described in Note 5 “Acquisition” in the Notes to Unaudited Consolidated Condensed Financial Statements.

### Revenue and Product Mix

Prior to the Company's introduction of its own proprietary radio products, for example ORION and GALAXY, Itron water utility-related products were a dominant radio products 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 radio products directly compete with Itron water radio products. In recent years, many of the Company's customers have selected the Company's proprietary products over Itron products. While the Company's proprietary product sales are generally greater than those of the Itron licensed products, the Company expects that Itron products will remain a significant component of sales to water utilities. Continuing substantial sales in both product lines underscores the continued acceptance of radio 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 2011, the Company introduced AMA as a hardware and software solution for water and gas utilities, and then in early 2014 launched its new BEACON AMA system as a managed solution which it believes will help maintain the Company's position as a market leader. Results for this new product were not significant in the first quarter of 2013.

The Company continues to seek opportunities for additional revenue enhancement. For instance, the Company is periodically asked to oversee and perform field installation of its products for certain customers. The Company assumes the role of general contractor, hiring installation subcontractors and supervising their work. The Company also supports its product and technology sales with the sale of extended service programs that provide additional services beyond the standard warranty. In recent years, the Company has sold ORION radio technology to natural gas utilities for installation on their gas meters. With the exception of a large sale of gas radios to one particular customer several years ago, 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 March 31, 2014

The Company’s net sales for the three months ended March 31, 2014 increased \$11.7 million, or 16.3%, to \$83.5 million compared to \$71.8 million during the same period in 2013. The increase was the net result of higher sales of municipal water and flow instrumentation products, offset slightly by lower specialty product sales.

Municipal water sales increased \$10.9 million, or 23.3%, to \$57.7 million in the first quarter of 2014 from \$46.8 million in the first quarter of 2013. These sales represented 69.1% of sales for the three months ended March 31,

2014. The increase was due to higher sales of residential meters both with and without radio technology as well as higher commercial meter sales. Sales of residential meters increased 17.6% due primarily to higher volumes of product sold. Commercial meter sales increased 62.4% in this period over the same period in 2013 also due to higher volumes of products sold. Winter weather and a particular quarter's mix of customers can have an impact on overall results. The results in the first quarter of 2013 were adversely affected by weather for that quarter's particular mix of customers. While weather also had an impact on the first quarter of 2014 for certain areas of the country, much of the sales increase in the quarter was due to customers in states that experienced a milder than normal winter.

Flow instrumentation products represented 28.4% of sales for the three months ended March 31, 2014 compared to 30.6% in the same period in 2013. These sales increased \$1.7 million, or 7.7%, to \$23.7 million from \$22.0 million in the same period last year. Sales were affected by higher volumes of products sold in most of this category's product lines.

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Specialty application products represented 2.5% of sales for the three months ended March 31, 2014. These sales decreased \$0.9 million, or 30.0%, in the first quarter of 2014, to \$2.1 million from \$3.0 million during the same period in 2013. The decrease was due primarily to lower sales of gas radios, offset slightly by an increase in sales of concrete vibrators.

Gross margin as a percentage of sales was 34.7% in the first quarter of 2014 compared to 34.9% in the first quarter of 2013. The slight decline was due to product mix as there were increases in manually read meters that carry lower margins. Offsetting this somewhat were higher unit volumes and better capacity utilization.

Selling, engineering and administration expenses for the three months ended March 31, 2014 increased \$0.9 million, or 4.7%, from the same period in 2013. Included in this year's expenses were charges totaling \$1.7 million (approximately \$0.07 per diluted share) related to due diligence and other transaction costs related to a potential acquisition that ultimately was not pursued. The remainder of the change in selling, engineering and administration expenses for the three months ended March 31, 2014 compared to the same period in 2013 was due primarily to lower product development costs as compared to last year when significantly higher charges were being incurred for products now released. Product development expenses in the most recent quarter returned to more historic levels.

Operating earnings for the first quarter of 2014 increased \$3.0 million, or 63.8%, to \$7.7 million compared to \$4.7 million in the same period in 2013 primarily as a result of the higher sales and gross margins, offset by higher selling, engineering and administration expenses.

Interest expense for the quarter ended March 31, 2014 increased slightly compared to the first quarter of 2013 due to higher average debt balances.

The provision for income taxes as a percentage of earnings before income taxes for the first quarter of 2014 was 37.4% compared to 35.1 % in the first quarter of 2013. The increase was due primarily to the recognition in the first quarter of 2013 of 2012 research and development credits identified in the first quarter of 2013 due to enacted legislation. Other components of the provision for income taxes were similar in both periods.

As a result of the above mentioned items, net earnings for the first three months ended March 31, 2014 were \$4.6 million, or \$0.32 per diluted share, compared to \$2.9 million, or \$0.20 per diluted share, for the same period in 2013.

## Liquidity and Capital Resources

The main sources of liquidity for the Company are cash from operations and borrowing capacity. Cash provided by operations was \$0.6 million for the first three months of 2014 compared to \$4.3 million in the same period in 2013. The effects of higher net income in the first three months of 2014 were offset by the increase in receivables and inventories.

Receivables increased from \$50.1 million at December 31, 2013 to \$54.7 million at March 31, 2014. Generally, sales are lower in the fourth quarter resulting in lower receivable balances at year end. The Company believes its net receivables balance is fully collectible.

Inventories at March 31, 2014 increased \$3.1 million to \$64.0 million at March 31, 2014 from \$60.9 million at December 31, 2013 due to timing of inventory purchases and support for improved sales.

Net property, plant and equipment at March 31, 2014 increased to \$77.3 million from \$76.4 million at December 31, 2013. This was the net effect of \$3.3 million of capital expenditures, partially offset by depreciation expense.



Intangible assets decreased to \$56.1 million at March 31, 2014 from \$57.3 million at December 31, 2013 due to normal amortization expense.

Short-term debt increased from \$70.0 million at December 31, 2013 to \$73.9 million at March 31, 2014 as the Company utilized its borrowing capacity for short-term working capital requirements.

Payables decreased to \$17.4 million at March 31, 2014 from \$18.6 million at December 31, 2013 due primarily to the timing of purchases and payments.

Accrued income and other taxes increased to \$3.1 million at March 31, 2014 from \$1.2 million at December 31, 2013 due to the higher net earnings and corresponding tax effect, as well as the timing of tax payments.

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Other non-current accrued employee benefits decreased to \$4.1 million at March 31, 2014 from \$4.4 million at December 31, 2013. The decrease was due to the first quarter 2014 payment of employee benefits related to 2013 operations, offset somewhat by employee incentives recorded in 2014 for results to date.

The overall increase in total shareholders' equity from \$196.6 million at December 31, 2013 to \$199.8 million at March 31, 2014 was the net effect of net earnings and stock options exercised, offset by dividends paid.

The Company's financial condition remains strong. In May 2012, the Company signed a credit agreement that increased its principal line of credit from \$90.0 million to \$125.0 million with its primary lender for a three year period. The line was reduced by \$16.7 million in May 2013 and will be reduced by a similar amount in May 2014. While the facility is unsecured, there are a number of financial covenants with which the Company is in compliance. The Company believes that its operating cash flows, available borrowing capacity, and its ability to raise capital provide adequate resources to fund ongoing operating requirements, future capital expenditures and the development of new products. The Company continues to take advantage of its local commercial paper market and carefully monitors the current borrowing market. The Company had \$44.1 million of unused credit lines available at March 31, 2014.

Other Matters

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

The Company is subject to contingencies related to environmental laws and regulations. The Company is named as one of many potentially responsible parties in two landfill lawsuits. The landfill sites are impacted by the Federal Comprehensive Environmental Response, Compensation and Liability Act and other environmental laws and regulations. At this time, the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. This belief is based on the Company's assessment of its limited past involvement with these landfill sites as well as the substantial involvement of and government focus on other named third parties with these landfill sites. However, due to the inherent uncertainties of such proceedings, the Company cannot predict the ultimate outcome of any of these matters. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2013 and the first quarter of 2014 were not material.

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

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, 2013 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, 2013 and have not materially changed since that report was filed unless otherwise indicated in this Form 10-Q.

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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, 2013 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 March 31, 2014. Based upon their evaluation of these disclosure controls and procedures, the Company's Chairman, President and Chief Executive Officer and the Company's Senior Vice President - Finance, Chief Financial Officer and Treasurer concluded that, as of the date of such evaluation, the Company's disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the quarter ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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Part II – Other Information

Item 6 Exhibits

Exhibit No.	Description
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 March 31, 2014 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Condensed Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Condensed Statements of Cash Flows, (v) Notes to Unaudited Consolidated Condensed Financial Statements, tagged as blocks of text and (vi) document and entity information.

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SIGNATURES

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

BADGER METER, INC.

Dated: April 23, 2014

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

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

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

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BADGER METER, INC.

Quarterly Report on Form 10-Q for the Period Ended March 31, 2014

Exhibit Index

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