

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10K

(mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1996

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION  
PERIOD FROM TO

COMMISSION FILE NUMBER 0-22418

ITRON, INC.

(Exact name of registrant as specified in its charter)

WASHINGTON

(State of Incorporation)

91-1011792

(I.R.S. Employer Identification Number)

2818 NORTH SULLIVAN ROAD  
SPOKANE, WASHINGTON 99216-1897  
(509) 924-9900

(Address and telephone number of registrant's principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to section 12(g) of the Act:

TITLE OF EACH CLASS  
COMMON STOCK, NO PAR VALUE

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 if disclosure of delinquent filers pursuant to Item  
405 of Regulation S-K is not contained herein, and will not be contained, to  
the best of registrant's knowledge, in definitive proxy or information  
statements incorporated by reference in Part III of this Form 10-K or any  
amendment to this Form 10-K.

As of February 26, 1996, there were outstanding 13,418,684 shares of the  
registrant's common stock, no par value, which is the only class of common or  
voting stock of the registrant. As of that date, the aggregate market value of  
the shares of common stock held by non affiliates of the registrant (based on  
the closing price for the common stock on the Nasdaq National Market on  
February 26, 1996) was approximately \$138,931,538.

## DOCUMENTS INCORPORATED BY REFERENCE

The information called for by Part III is incorporated by reference to the definitive Proxy Statement for the Annual Meeting of Shareholders of the Company to be held April 29, 1997.

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## PART I

## ITEM 1: BUSINESS

## OVERVIEW

Itron, Inc. ("Itron" or the "Company"), was incorporated in Washington in 1977 and is a leading global provider to the utility industry of data acquisition and wireless communications solutions for collecting, communicating and analyzing electric, gas and water usage. The Company designs, develops, manufactures, markets, installs and services hardware, software and integrated systems for handheld computer-based electronic meter reading ("EMR"), automatic meter reading ("AMR") and other measurement systems.

Since the early 1980s, Itron has been the leading supplier of EMR systems to utilities. Today, Itron's EMR systems are installed at over 1,500 utility customers in more than 40 countries and are being used to read approximately 275 million meters worldwide. Itron's EMR systems are installed at 80% of the 249 utilities in North America with 50,000 or more meters, including 21 of the largest 25 utilities. EMR systems and services currently account for approximately 25% of the Company's total revenues.

In the early 1990s, Itron expanded its product line to include AMR systems and services. The Company estimates there are approximately 268 million meters in North America, of which only approximately 12 million, or 5%, currently have installed AMR technology. Outside North America, the Company estimates there are two to three times that number of meters and minimal AMR installations. The Company has shipped over 8.4 million AMR meter modules to 269 utilities as of December 31, 1996, and has thereby established itself as the world's leading supplier of AMR systems. Fifty-seven of these 269 utilities have made a sizable commitment to Itron AMR products by having installed at least 10,000 Itron AMR meter modules. AMR systems and services now represent approximately 75% of the Company's total revenues.

The Company's AMR systems and products were initially developed to enable utilities to reduce operating costs and improve quality of service and are being expanded to provide a full range of utility and nonutility related data management capabilities and communications-based options. The Company believes its AMR product offerings are more extensive than that of any other AMR supplier. The Company's AMR systems and products support electric, gas, water and combination utilities and include solutions for all classes of utility customers--residential, commercial and industrial. The Company's AMR solutions involve the use of radio and, in some instances, telephone technology to collect meter data. The Company's radio-based AMR solutions include handheld ("Off-Site"), vehicle-based ("Mobile") and fixed network ("Fixed Network") reading technology options. Each of the radio-based reading options utilizes the same AMR meter module technology, which therefore provides a compatible migration path from basic Off-Site AMR to more advanced Mobile and Fixed Network systems. This compatibility allows Itron's customers to initiate AMR installation on a limited number of meters with the flexibility to expand to full-scale, system-wide implementation on a large number of meters, where multiple AMR solutions may be required. The range of Itron's AMR product offerings enables its customers to deploy the solutions that are the most effective in each portion of the utility's service territory at the appropriate time.

Regulatory reform initiatives and merger activity are causing significant changes in the utility industry and have recently caused some utility customers to delay implementation of AMR technology. The Company believes that regulatory reform will require more frequent collection of meter data with a degree of resolution not previously needed and therefore will increase demand for AMR products. In addition, the Company believes that, over the long term, regulatory reform in many states will create new AMR opportunities for the Company such as the development of reconciliation systems for the supply of power to, and purchase of power from, the electric power transmission grids, software to support the complex

billing for large commercial and industrial customers, franchise operations, national accounts and aggregators (power brokers that purchase power on behalf of many customers), and products to support nontraditional utility applications such as energy management programs, home automation systems, and premise monitoring services, such as home security.

The Company believes that its broad offering of AMR products provides utilities and other industry participants with numerous options for converting recurring operating expenses of meter reading into strategic investments that provide high-value communications links with customers. The Company believes this extensive product portfolio, along with significant experience in high-volume AMR meter module production, established relationships with over 1,500 utilities worldwide, proven interfaces with numerous utility host billing systems, and advanced software for large commercial and industrial customers and power exchanges, positions the Company to take advantage of this significant AMR market opportunity.

#### DESCRIPTION OF BUSINESS

##### OVERVIEW OF CURRENT ENVIRONMENT IN THE UTILITY INDUSTRY

The utility industry is undergoing fundamental structural changes. Current restructuring in the electric utility industry is focused on opening the electric power generation industry to full competition and ultimately providing retail customers access to multiple suppliers (referred to as "direct access"). Similar to regulatory changes that have already occurred in the transportation and telecommunications industries, customer demands and regulatory mandates by federal and state governments are forcing utilities to make the transition from regulated monopolies in certain respects into competitive enterprises.

Federal legislation, such as the National Energy Policy Act of 1992 (the "EP Act"), eased restrictions on independent power producers in an effort to increase competition in the wholesale electric power generation market and authorized the Federal Energy Regulatory Commission ("FERC") to mandate utilities to transport and deliver ("wheel") energy for a supplier of bulk power to wholesale customers. On April 24, 1996, in a landmark ruling, FERC announced two new rules (Order Nos. 888 and 889) designed to accelerate competition and bring lower prices and more choices to energy consumers. Order No. 888 opens wholesale power sales to competition by requiring public utilities to offer nondiscriminatory pricing to all users of their transmission lines. Order No. 888 also provides for the full recovery of stranded costs. Order No. 889, also known as the Open Access Same-time Information System ("OASIS") rule, requires public utilities to obtain information about their transmission system for their own wholesale power transactions, such as available capacity, in the same way their competitors do--via OASIS on the Internet.

Regulatory and legislative activity at the state level regarding retail wheeling and direct access has recently increased dramatically. While regulatory initiatives vary from state to state, many involve the separation of certain functions currently performed by utilities, including energy generation, transmission and distribution (functional unbundling) and a shift from rate-of-return to performance-based ratemaking or market-based pricing. All states except one have undertaken some form of regulatory reform, with 35 states having discussion forums on the topic, 17 states having undertaken legislative studies and 22 states having had relevant bills introduced in their legislatures.

California is the furthest along in implementing retail wheeling, requiring utilities to offer an initial group of customers the ability to choose their electricity supplier by January 1, 1998, with all customers having this ability by 2002. California is considering many regulatory reform alternatives, including functional unbundling, as well as the possible unbundling of the metering function and the customer billing function. Regulators in New York, Massachusetts, Michigan, New Hampshire and Vermont have all

ordered utilities to file restructuring plans which would address, among other competitive issues, a schedule for implementing retail wheeling over the next several years.

While some utility companies may retain some, most or all of their traditional functions, the Company believes that it is likely that some of these functions will, in some jurisdictions, also be provided by separate independent system operators ("ISOs") and energy service providers ("ESPs"). Utilities may turn the operational control of certain of their transmission facilities over to ISOs. ESPs are expected to provide both electricity and natural gas to commercial, industrial and residential customers and may, in some jurisdictions, perform meter reading and customer billing for themselves and/or several utilities. ESPs have already emerged, and may continue to emerge, as individual companies (e.g., Enron) or consortiums. Thus, the Company's future customer base will likely be comprised of both ESPs and traditional utility companies. Such companies also will buy and sell electricity and will have to deal with the frequent specification of prices and costs for the transference of power. As such companies emerge, the Company believes that the ability to measure the supply and use of energy on a frequent basis will become increasingly critical and that the electric service industry will be driven toward hourly or half-hourly usage and pricing.

The Company believes the advancement of regulatory reform initiatives will motivate utilities and industry participants to increase operating efficiencies, enhance service quality and offer services not traditionally offered by utilities. In light of this, the Company believes industry participants will:

- require a variety of AMR alternatives to address diverse characteristics across service territories;
- strive to reduce the recurring operating cost of meter reading;
- move toward the use of real time pricing, which requires more frequent reads;
- ensure distribution reliability by pinpointing outages rapidly and line loss problems accurately; and
- differentiate services by offering innovative billing plans and nonutility services such as home security, energy management and remote status monitoring.

#### ITRON SOLUTIONS

The Company believes it has an extensive and cost-effective portfolio of AMR solutions that provides utilities and other industry participants with numerous options for responding to evolving operational needs, marketing opportunities and regulatory reform requirements.

**Broad Product Line Offering.** Itron's core AMR meter module technology has been adapted to read numerous types of electric, gas and water meters, including the most common meter types made by major meter manufacturers. Itron's broad product line enables utilities and other industry participants to perform meter reading functions for themselves, as well as for other utilities or power suppliers serving a particular geographic area. Itron's AMR solutions include the use of both radio- and telephone-based technologies and support all classes of utility customers--residential, commercial, large commercial and industrial.

**Low Cost Provider--Manufacturing Capabilities and Experience.** Having shipped more than 8.4 million meter modules since 1987, the Company believes it is the AMR industry's most experienced meter module provider. The Company believes that its low AMR meter module production costs are a key

competitive advantage and generally allow it to offer utilities economically justifiable AMR solutions. The Company made substantial investments in high-speed automation and test manufacturing equipment in 1996 to strengthen further its position as a low-cost provider of meter modules.

**Technology Migration Pathways.** The Company's radio-based AMR solutions encompass Off-Site, Mobile and Fixed Network reading technology options. Because the same AMR radio meter modules can be used with any of these alternatives, the Company's products facilitate the migration from one level of systems automation to another. This flexibility means that utilities can begin to achieve immediate economic benefits from their initial investments in AMR systems, while also expecting these systems to be the foundation on which to build future AMR solutions.

**Benefit Optimized Deployment.** The range of AMR solutions offered by the Company enables its customers to deploy the solutions that are the most cost effective in each portion of the utility's service territory. The Company has developed a conceptual and analytical methodology--termed "Benefit Optimized Deployment"--which facilitates a potential AMR customer's comprehensive and quantified analysis of the question "What technology, where and when?" The Company has implemented this methodology in the form of a user-friendly Windows-based computer program to assist utilities and other industry participants in evaluating and then optimizing the use of different product solutions in different circumstances and at different times.

**Nationwide Radio Spectrum and Intellectual Property Rights.** The Company has been issued a renewable nationwide U.S. Federal Communications Commission ("FCC") license to operate in the 1427-1429 MHz band, allowing it to operate its Fixed Network AMR technology throughout the United States. Itron believes the spectrum available under this license is adequate to meet the spectrum requirements for Fixed Network AMR and the requirements for a substantial implementation of advanced utility functionality, as well as certain nonutility applications. Itron also owns what it believes to be a significant patent relating to network-based AMR that provides it with numerous options for further AMR deployment, including licensing its technology to others.

**Multiple Financing Solutions.** The Company provides alternative ways in which to finance AMR technologies. The Company sells products, outsources entire systems and arranges lease financing for its customers.

#### ITRON'S STRATEGIES

Itron's objective is to continue to be a leading provider of AMR solutions to utilities as well as other industry participants and to maintain over time the broadest portfolio of cost-effective AMR and related solutions. Following are key elements of the Company's strategy:

**Provide Cost-Effective Meter Reading Solutions.** The Company intends to take advantage of the current regulatory environment to expand further its Off-Site and Mobile AMR customer base. The Company offers a broad range of meter reading solutions that allow utilities to realize immediate cost savings through automation of their meter reading function. Despite concerns of stranded assets and other uncertainties caused by impending regulatory reform of the electric utility industry, utilities can confidently invest in the Company's core business products (EMR, Off-Site and Mobile AMR) because of the relatively short period of time in which they can recoup their investment through cost savings. Investments in these core business products enable utilities to convert recurring operating expense of meter reading into strategic investments that provide a migration path to Itron's Fixed Network AMR solution and a high-value communications link with customers.

**Expand Fixed Network AMR Technology and Installations.** The Company is committed to delivering Fixed Network AMR solutions and believes that the demand for fixed network AMR will grow significantly as electric utilities increasingly focus on the consequences of competition brought on by

regulatory reform. The Company is committed to the expansion and completion of its Fixed Network AMR installation at Duquesne Light Company ("Duquesne"), the expansion of select pilot Fixed Network AMR installations, and the continued enhancement of its Fixed Network AMR technologies and products. The Company believes that fixed network AMR is, and for the foreseeable future will continue to be, the lowest-cost manner in which to provide frequent, time-critical meter reads, and will increasingly be critical for the competitive success of utility industry participants as regulatory reform unfolds.

Develop Additional Products to Serve Large Commercial and Industrial Markets. The Company intends to substantially broaden its AMR product line for large commercial and industrial customers, which represent on average approximately 35% of a utility's total customer revenues. This includes developing power billing systems targeted to utilities and power marketers that must support complex billing for large commercial and industrial customers, franchise operations, national accounts and aggregators (power brokers that purchase energy on behalf of many customers), expanding and modifying its software currently used in the United Kingdom for reconciliation of power provided by generators to, and withdrawn by distribution companies from, electric power transmission grids for use in the United States, interfacing UTS software with the Company's other AMR products, and adapting and integrating certain aspects of the Company's international Fixed Network solutions for large commercial and industrial customers.

Build Upon Extensive Customer Base and Industry Experience. Itron has established itself as the world's leading supplier of AMR systems as a result of its having shipped more than 8.4 million AMR meter modules to 269 utilities as of December 31, 1996. The Company's EMR systems have been installed at over 1,500 utilities in more than 40 countries, and are being used to read approximately 275 million meters worldwide. Further, the Company's handheld EMR systems have been installed at more than 80% of the 249 utilities in North America that have meter populations greater than 50,000 reported customer meters. The Company believes that its extensive customer base, long-term relationships with its customers, and proven interfaces with numerous utility host billing systems provide a solid foundation upon which the Company can expand its product offerings and services to existing utility customers, as well as new utility customers and other industry participants.

Develop Technology for Related Nonutility Applications. The Company is working with a number of strategic partners and others on the development of its AMR systems and products in order to support nonutility services. These services could include premise automation and monitoring services such as security and alarm services, remote status monitoring of vending machines, traffic lights and propane tanks, and energy management solutions.

#### AUTOMATIC METER READING SYSTEMS AND PRODUCTS

The Company's AMR product line, known as "Genesis by Itron(R)," involves the use of radio and, in some instances, telephone technology to collect meter data. The Company's radio-based AMR solutions encompass Off-Site AMR, Mobile AMR and Fixed Network AMR, as well as a variety of supporting services and products. Due to the geographic features and varying population density of a utility's coverage area, generally no single meter reading solution is ideally suited to all parts of the utility's service area. Itron's AMR applications are intended to provide functionality ranging from selective installation on high-cost-to-read meters to full implementation of an AMR system covering appropriate segments of a utility's service area. This flexibility enables utilities to achieve immediate economic benefits from their initial investments in the Company's AMR systems, while enabling migration to a more comprehensive AMR solution in the future.

Meter Modules. The Company's AMR product offerings are based on a family of meter modules. These meter modules, which can be easily attached to utility meters, encode consumption and tamper information and transmit this data, including meter identification, to a remote receiver. The Company

intends to continue to expand its meter module offerings through development of meter modules that read additional meter types, as well as development of modules with differing capabilities that will enable utilities to use the most cost-effective module for a particular meter reading need.

The Company began shipping its ERT (encoder, receiver, transmitter) model of radio meter modules to customers in late 1986. Itron has adapted the ERT's proven core technology to read numerous types of electric, gas and water meters, including the most common electric and gas meter types made by major meter manufacturers. The Company's compact radio meter modules for gas and water meters are self-contained low-power units, powered by long-life batteries with an expected minimum life in excess of ten years. Radio meter modules for electric meters are normally integrated under the glass of standard residential meters and do not require battery power. Radio meter modules can be installed by the meter manufacturer during the manufacturing process or easily retrofitted in existing meters.

In addition to its radio meter modules, the Company also offers its gas utility customers telephone-based AMR technology with its Metscan product line. For commercial and industrial applications, the Company's Metscan meter modules attach to large-volume gas meters and collect data, including consumption and interval-based time-of-use data used to bill transport gas and interruptible gas customers, as well as provide critical load survey data for applications such as peak day forecasting, supply forecasting and assessments, rate design and marketing. For residential applications, including hard-to-read meters, Metscan modules are attached to existing or new residential gas meters to provide consumption and load survey data.

The Company also offers a separate line of meter modules for use outside North America. The primary differences between the meter modules used by the Company in North America and those used in international markets are the radio frequency band in which they operate and the physical configuration of the module. In addition, the Company has developed meter module technology to address opportunities available in international markets that are not present in North America. For example, in certain European countries usage of steam and hot water produced by a central facility for residential heating is metered using devices known as "heat allocators" located on radiators. The Company has developed a radio-based meter module that enables remote collection of data recorded by heat allocators, eliminating the need to access each radiator in order to collect consumption data.

Off-Site Meter Reading. The Company's Off-Site AMR solution enables meters on which meter modules have been installed to be read remotely, by a person up to 800 feet away, with a handheld computer equipped with a radio unit. Off-Site AMR offers a practical and cost-effective way for utilities to read high-cost-to-read meters by eliminating the need for meter readers to gain visual access to those meters. Once a utility has upgraded its Itron handheld computers with radio technology, it can selectively install meter modules on high-cost-to-read meters. System software automatically identifies module-equipped meters within a route. When remote reads are needed, the system prompts the meter reader to initiate the wireless remote read. Meter information is shown on the handheld display and is automatically recorded in the handheld data base, allowing the meter reader to move on to the next meter on a route. When a route is completed, data from both visual and radio reads are uploaded from the handheld computer to the utility host system for customer billing.

Mobile AMR. The Company's Mobile AMR solution uses a data collection device mounted in a vehicle to collect and store data transmitted by meter modules as the vehicle passes module-equipped meters. The data collection device receives information transmitted by multiple meter modules simultaneously. A touch-screen display enables the operator to observe and operate the data collection device. The Mobile AMR application includes software which manages and moves information to and from a utility's billing system. Once installed, the software transfers information from the host system to create route files for the data collection device for each route, manages the storage of the meter data as it is

collected and, at the end of the day, uploads the information to the utility's billing system. A Mobile AMR system enables an operator to read up to 10,000 to 15,000 meters in an eight-hour day, compared to an average walking route of 500 meters per day. Factors affecting the actual number of reads per day include, among others, route density and design, speed limits, weather and environment. Mobile AMR also improves meter reader safety.

Fixed Network AMR. Itron's Fixed Network provides utilities with the capability of completely automating meter reading in desired segments of a utility's service area and thereby eliminating the need to send meter readers to or near customer premises. Ten of the Company's AMR customers have pilot installations of the Company's Fixed Network AMR system, and under a contract with Duquesne (the "Duquesne Contract"), the Company is installing a Fixed Network system that, when fully installed, will cover approximately 615,000 meters. It is intended that the Company's Fixed Network technology will be able to provide utilities with a number of utility-related applications, such as daily or more frequent meter reads, time of use pricing, on-demand meter reads, tamper monitoring and reporting, outage detection and power restoration reporting, load profiling and virtual connect/disconnect capabilities. Implementation of a Fixed Network AMR system would also enable a utility to perform meter reading services for other utilities in the same area, and to offer and develop new revenue-generating services, such as energy management programs, home automation systems and premise monitoring services, such as home security. Meter data collected by the Company's radio meter modules is transmitted to a Cell Control Unit ("CCU"), which is a neighborhood communications controller. The CCU performs memory and computational functions, in addition to functioning as a radio receiver and transmitter. Weighing approximately 15 pounds, Itron's CCU can be easily installed on utility poles, street lights, buildings or other locations. While the geographic area covered by each CCU varies depending on local topography, physical structures and other factors, in general the Company expects each CCU to serve approximately 50 homes. Information collected by CCUs is then transmitted to a Network Control Node ("NCN"), which is the primary routing and control device for the Fixed Network. The Company expects that each NCN will typically support approximately 500 CCUs. NCNs manage information in the network, communicate with CCUs and other NCNs and can serve as a gateway to other networks.

The final link in Itron's Fixed Network is from the NCNs to one or more of a utility's host computers, known as a Genesis Itron Host Processor (the "GIHP"). The GIHP is an open-architected control computer and database management system that provides network control and advanced AMR functionality, and acts as the interface to the Fixed Network from other utility systems. The GIHP acts as a Standard Query Language ("SQL") database server to utility host billing and operating systems. Communications between CCUs and NCNs and the utility's GIHP utilize the Company's nationwide licensed frequencies in the 1427-1429 MHz band. Communications between NCNs and a GIHP may utilize these frequencies or wired technology.

The Company made substantial investments in development of its Fixed Network in 1995 and 1996, and expects to continue to devote a significant portion of its product development spending in 1997 to Fixed Network development. Current product development efforts are focused on performance enhancements and additional functionality. See "--- Product Development."

#### EMR HANDHELD SYSTEMS AND PRODUCTS

Itron's handheld systems allow utilities to automate a substantial portion of their meter reading and billing functions. Itron provides six basic models of handheld computers to meet the varying requirements of its utility customers. Each model is designed for use in harsh environments with standard text and

graphics, backlit displays, several memory sizes, multiple communications options, interface devices for electronic meters and easy to use keyboards that can be customized for the needs of the utility customer.

Handheld systems are used as follows: (1) key customer data is downloaded from a GIHP to an Itron handheld computer prior to commencement of a meter reader's daily route; (2) the meter reader visually reads the meters along a route and enters the readings into an Itron handheld computer; and (3) after a meter reader's daily route has been completed, collected data is uploaded directly into a utility's host billing system. Itron's family of software systems provides data consolidation and storage, reformatting, linkage to the utility's host billing system, meter reading route management, route downloading, and time of use data management and distribution.

#### COMMERCIAL AND INDUSTRIAL SOFTWARE PRODUCTS AND SERVICES

The Company's UTS subsidiary is the leading provider in the United States of software systems for metering data acquisition and analysis for the large commercial and industrial customers of electric and gas utilities. UTS also has systems installed in about 20 countries outside the United States.

Commercial and industrial meters have much more sophisticated measurement capabilities than meters for residential customers, and therefore have much more data that must be conveyed back to a utility from the meter. There is a wide variety of these meters with no standards for communications between meters supplied by multiple vendors and central utility computers. The key to UTS' development of the commercial and industrial products and services market has been its establishment of strategic relationships with meter suppliers around the world to solve the "no standard communication protocol" problem.

UTS' Multiple Vendor Data Collection and Analysis System (the "MV-90") supports communication protocols for almost all the large commercial and industrial electric and gas meter suppliers in the United States and Europe. UTS' multi-vendor data retrieval and analysis systems support all methods of data retrieval from large commercial and industrial meters (handheld readers, cartridges and telephone). The MV-90 was designed with a full range of applications software to support data collection from meters, data validation and editing and analysis of energy usage data. MV-90 software can be licensed for use on single computers and local/wide area networks, and on a site license basis. In addition to the base system there are layered application packages that support applications such as load research, real time pricing (hourly price transmission to commercial and industrial customers), gas transportation and interruptible rates (notification and control of loads at large commercial and industrial customers).

UTS has capitalized on a specialized market within the electric utility industry and now supplies MV-90 software for revenue billing, load research and demand-side management to approximately 70% of the major utilities in the United States and to most of the utilities in Canada, Europe, the Middle East, Australia, Central America and South America. The Company estimates that approximately 35% of the \$250 billion annual revenues billed by the electric utility industry in the United States is billed using data collected by the MV-90 software systems.

The Company believes that competition in the utility industry will drive metering technology and systems toward enhancing and facilitating communications between large commercial and industrial customers and their power suppliers. UTS has developed a "read only" version of the MV-90 software which allows the commercial and industrial customers to read the utility's delivery point meters (both electric and gas) on a frequent basis to analyze their energy consumption. This software can also receive hourly pricing data from the energy supplier for customers who purchase power on a real time pricing basis (price varies by the hour). It also supports load curtailment with messaging to notify larger commercial and industrial customers of these events. The read only, real time pricing, and load control software is sold to commercial and industrial customers by the marketing departments of various utilities. This secondary market is very significant because the large base of commercial and industrial customers that become candidates for this software.

UTS is now developing a large power billing system (the "MV-PBS") targeted to utilities and power marketers that must support complex billing for large commercial and industrial customers, franchise operations, national accounts and aggregators (power brokers who purchase energy on behalf of many customers). The MV-PBS is designed to allow utilities to bill energy and related services sold under complex contracts, where each contract for products and services may be unique to that customer. The current legacy billing systems were designed for large volume, rate class billing with very little flexibility to bill complex contracts required for unbundling of power (generation, transmission and distribution), as well as new products such as real time pricing and retail wheeling. The MV-PBS will be developed for use in a client-server environment and is fully integrated with the MV-90 multi-vendor data collection system.

As the electric utility industry is restructured in certain jurisdictions, the metering function of the generation/transmission/distribution systems interface will sometimes be managed by independent entities such as power exchanges and ISOs. UTS currently supplies the software to collect the metering data for the power exchanges in the United Kingdom, Australia and New Zealand. UTS is in an excellent position to also supply software to states such as California, New York, Pennsylvania, Michigan and others as they establish similar power exchange/independent system operations to manage the deregulated power supply industry in their states.

The Company also has increased its domestic product development efforts towards substantially broadening its large commercial and industrial AMR product line. This development includes interfacing MV-90 software with the Company's radio-based AMR meter modules and other AMR products.

#### STRATEGIC ALLIANCES

From time to time, the Company enters into strategic alliances with utilities and others for the development of systems and products. The Company has a strategic alliance with IBM Global Services, a division of International Business Machines, to develop and market network solutions jointly in support of customer services such as automated meter reading, as well as premise automation, home security, vending machine monitoring and other nonregulated services. In support of this alliance, IBM Global Services has integrated the Company's Fixed Network AMR with its back office applications and billing systems in its Utility Industry Applied Technology Lab.

In addition, the Company has entered and expects to enter into a number of joint ventures or alliances with both nonregulated and regulated utility entities, among others. These alliances and joint ventures are expected to offer a wide range of services, such as resale of Itron products, meter module and network installation, AMR outsourcing, network-based information services and further development of applications to maximize the benefit and use of Itron's AMR product offerings.

#### CUSTOMERS

Itron has established itself as a leading supplier of handheld EMR systems and AMR meter modules for the AMR market. The Company believes that its extensive customer base, long-term customer relationships and experience in meeting the needs of the utility industry provide a solid foundation from which it can supply additional products and services to its existing customers, as well as new utility customers and other industry participants.

Itron's EMR systems are installed at over 1,500 electric, gas, water and combination utilities in more than 40 countries and are being used to read approximately 275 million meters worldwide. Itron's EMR systems are installed at 80% of the largest utilities in North America. These 249 utilities, with greater than 50,000 customer meters each, represent approximately 176 million of the approximately 268 million meters in North America. As a result of the high market penetration the Company has already achieved in

the United States, domestic EMR sales are expected to be predominantly system upgrades and replacements. The Company estimates that the number of meters outside North America is approximately two to three times the number of meters in North America. Because utilities in many industrialized countries outside North America are only now beginning to automate their meter reading function, the Company believes that international markets represent a growth opportunity for sales of its EMR systems.

The Company has established itself as the world's largest supplier of meter modules for the expanding AMR market as a result of having shipped over 8.4 million meter modules as of December 31, 1996. During the year ended December 31, 1996, the Company shipped a record 2.5 million AMR meter modules and added 88 utilities to its list of AMR customers, bringing the total number of the Company's AMR customers to 269 utilities, including 20 utilities located outside the United States. Fifty seven of Itron's 269 AMR customers have made a sizable commitment to Itron AMR products by having each ordered and installed at least 10,000 of the Company's meter modules as of December 31, 1996, for a combined installation total of 8 million meter modules by these 57 customers.

The Company has installed the world's largest AMR system for Public Service Company of Colorado ("PSCO"), with currently over one million meter modules. This system is being read with Mobile AMR technology. The Company also is in the process of installing what it believes is currently the world's largest announced radio-based water AMR system with the city of Milwaukee. The Company also is in the process of installing a radio-based commercial and industrial AMR project with Energy Australia, that involves the installation of 3,000 end points and represents a significant entry by the Company into product lines that serve this critical group of customers.

In addition, ten of the Company's AMR customers have pilot installations of the Company's AMR Fixed Network system and, under the Duquesne Contract, the Company is installing a Fixed Network system that, when fully installed, will cover approximately 615,000 meters. See "Certain Risk Factors-- Dependence on the Installation, Operations and Maintenance of AMR Systems Pursuant to Outsourcing Contracts."

#### SALES, DISTRIBUTION AND MARKETING

Itron utilizes a direct sales and technical support team to serve its major accounts, with sales and technical support offices located in multiple cities throughout the United States. For smaller utilities and municipalities in North America, Itron conducts sales and support activities through numerous distributors. As of January 31, 1997, the Company's North American direct sales force was comprised of 20 account executives and three area vice presidents, who are supported by three sales engineers. In addition, the Company's direct sales force includes four individuals who are responsible for managing the Company's relationships with its distributors. Outside North America, the Company maintains direct sales organizations within subsidiary operations in the United Kingdom, France and Australia. To reach the broader international market, the Company conducts sales through distributors in approximately 45 other countries.

In addition to direct sales and sales through distributors, the Company makes electric meter modules available to utilities through original equipment manufacturer ("OEM") arrangements with several major electric meter manufacturers, who incorporate the Company's meter modules at their own facilities into new electric meters. The Company intends to enter into additional OEM or other similar arrangements if it has attractive opportunities to do so. Further, the Company has licensed certain aspects of its meter module technology to Schlumberger Ltd. ("Schlumberger") and may enter into additional licensing agreements with other meter manufacturers or other industry participants in the future.

The Company also offers its products and services through long-term outsourcing arrangements, which may include providing AMR products, system installation, meter reading services and meter shop

services for periods of 15 years or more. Outsourcing arrangements can be structured in a variety of ways to address a utility's specific needs and range from providing basic meter reading systems and services to providing systems and services with advanced functionality. The Company offers these services to utilities directly and through joint ventures with utilities and other industry participants. To date, the Company has entered into three outsourcing arrangements. See "Certain Risk Factors--Dependence on the Installation, Operations and Maintenance of AMR Systems Pursuant to Outsourcing Contracts."

Key components of the Company's sales and marketing strategy are to provide utilities with cost-benefit analyses of potential purchases of the Company's products and to help utilities design a deployment strategy for the Company's products that will optimize the benefits realized by the utility. See "-- Itron's Strategies--Provide Cost-Effective Meter Reading Solutions." The Company believes that the relatively short cost recovery period for deployment of Off-Site and Mobile AMR systems, particularly on hard-to-read meters, makes an investment in such technology an attractive solution for a utility's meter reading needs, despite uncertainty caused by industry consolidation and regulatory reform. The Company's marketing program also emphasizes the diversity and flexibility of its product line and the Company's ability to offer total product solutions to each of its utility customers.

The Company's other marketing efforts focus on product awareness principally through trade shows, symposiums, published papers and direct mail. These marketing efforts include brochures, newsletters, exhibits, conferences, an annual user's forum, industry standards committee representation and regulatory support. Several major industry conferences are keystones in the Company's marketing program, including the Distribution Automation/Demand Side Management Conference held every January, the Company's Annual Users Conference held every June in conjunction with the National Meter Reading Association meetings and the Automatic Meter Reading Association conference usually held in September. The Company maintains communications with its customers through its Users Advisory Board and its Fixed Network Advisory Group and a program of regular mailings, newsletters and new customer announcements.

#### CUSTOMER SERVICE AND SUPPORT

Itron provides its utility customers with full implementation services, including system design, installation, training and project management. Each of these services is tailored to meet a particular utility's needs. For large-scale AMR installations, Itron offers turn-key programs under which it is responsible for installing meter modules and a communications network. Itron also offers system maintenance and support services to each of its customers. Service contract prices are based on a number of factors, including system size and complexity and the expected degree of service support required. The Company's system maintenance and support services include 24-hour, toll-free hot line support, customer service representatives, consulting services, regional training programs, equipment repair and preventative maintenance, software support and maintenance, system troubleshooting and network management services.

#### COMPETITION

Although the Company is the industry leader in sales of AMR meter modules and AMR systems and services to the utility industry, it faces competitive pressures from a variety of companies in each of the markets it serves. In the radio-based Fixed Network AMR market, for example, companies such as CellNet Data Systems, Inc. ("CellNet") currently offer alternative solutions to the utility industry and compete aggressively with the Company. The emerging market for Fixed Network AMR systems for the utility industry, together with the potential market for other applications once such Fixed Network systems are in place, have led communications, electronics and utility companies to begin developing various systems, some of which currently compete, and others of which may in the future compete, with the Company's Fixed Network AMR system. These

competitors can be expected to offer a variety of technologies and communications approaches, as well as meter reading, installation and other services to utilities and other industry participants.

The Company believes that several large suppliers of equipment, services or technology to the utility industry have developed or are currently developing competitive products for the AMR market. For example, Schlumberger offers a competitive electric meter module for its newly manufactured meters and has entered into a joint venture with Motorola, Inc. for AMR product development. In addition, other large meter manufacturers could expand their current product and services offerings so as to compete directly with the Company. To stimulate demand, and due to increasing competition in the AMR market, the Company has from time to time lowered prices on its AMR products and may continue to do so in the future. The Company also anticipates increasing competition with respect to the features and functions of such products. In the handheld systems market, Itron has encountered competition from a number of companies, resulting in margin pressures in the maturing domestic handheld systems business.

The Company believes, however, that it enjoys several competitive advantages in each of its markets. It has a substantially larger installed base of handheld-based EMR systems and AMR meter modules than any of its competitors. The Company's relatively large installed base of these systems gives it the advantage of a proven record of providing cost-efficient, quality products and services that enable utilities to migrate from a selective installation of AMR solutions to a more comprehensive deployment of AMR. In addition, through these installations, the Company has the proven ability to interface meter data with a wide variety of utility host billing systems. The diversity of the Company's product lines gives it the flexibility to provide comprehensive solutions to its utility customers, and affords the Company the flexibility to respond to changes in the utility industry and the regulatory environment. The Company believes that it is able to price its products competitively as a result of its highly automated manufacturing lines. In addition, the Company believes that its nationwide license of 1-2 MHz of spectrum in the 1427-1429 MHz band gives it a significant advantage over its current competitors in serving its current and future customers. See "-- FCC Regulation."

Many of the Company's present and potential competitors have substantially greater financial, marketing, technical and manufacturing resources, name recognition and experience than the Company. The Company's competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the development, promotion and sale of their products and services than the Company. In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties that increase their ability to address the needs of the Company's prospective customers. Accordingly, it is possible that new competitors or alliances among current and new competitors may emerge and rapidly gain significant market share. There can be no assurance that the Company will be able to compete successfully against current and future competitors, and any failure to do so would have a material adverse effect on the Company's business, financial condition, results of operations and cash flow. See "Certain Risk Factors--Competition."

#### PRODUCT DEVELOPMENT

The Company's product development efforts are focused on further expanding and upgrading its meter module and other product offerings for its AMR systems and developing new hardware and software platforms for handheld systems. The Company has product development facilities located in Spokane, Washington; Lakeville and Waseca, Minnesota; Raleigh, North Carolina; and Saratoga, California. It also conducts some development activities in each of its foreign subsidiaries. The Company has maintained its leadership position in part because of its commitment to new products and continued enhancement of existing products. The Company spent approximately \$33.3 million in 1996, \$27.1 million in 1995 and \$18.1 million in 1994 on product development. Product development expenses in 1995 and 1994 were net of capitalized software costs of \$62,000 and \$3.1 million, respectively. The Company did not capitalize any software costs in 1996.

The Company expects to continue to invest substantial amounts on new product development for the foreseeable future as it continues to expand and enhance its AMR and other product offerings. Utilizing its broad knowledge of the utility industry and the regulatory environment, the Company prioritizes its product development opportunities to attempt to satisfy current customer needs on a timely basis. In the last two years, a significant portion of the Company's product development expenditures has been for development of its Fixed Network technology. The Company expects that the single largest category of its future product development expenditures will be for the commercial delivery of advanced functionalities for its Fixed Network.

The Company's future success will depend in part on its ability to continue to design and manufacture new competitive products, as well as to enhance its Fixed Network and other AMR products. There can be no assurance that the Company will not experience unforeseen problems or delays with respect to its product development efforts. Delays in the availability of new and enhanced products could have a material adverse effect on the Company's business, financial condition and results of operations. See "Certain Risk Factors--Dependence on New Product Development."

#### INTELLECTUAL PROPERTY

Itron owns or licenses numerous United States, Canadian and foreign patents and has filed various patent applications. These patents cover a range of technologies for meter reading, portable handheld computer and AMR-related technologies. In September 1996, the U.S. Patent and Trademark Office issued to the Company what the Company believes to be a very significant patent for radio-based network AMR systems. On October 3, 1996, the Company brought an action in the United States District Court for the District of Minnesota against CellNet claiming infringement of this patent. The discovery phase of this proceeding has commenced. See "-- Legal Proceedings." The Company also relies on copyrights to protect its proprietary software and documentation. The Company has registered trademarks for most of its major product lines in the United States and many foreign countries.

While the Company believes that its patents, trademarks and other intellectual property have significant value, there can be no assurance that these patents or trademarks, or any patents or trademarks issued in the future, will provide meaningful competitive advantages. The Company believes that its continued success will be based on continued excellence and innovation of its products, market knowledge, technical and marketing capabilities, existing relationships with utilities and a fundamental commitment to customer service excellence. See "Certain Risk Factors--Intellectual Property."

#### FCC REGULATION

Certain of the Company's products made for use in the United States use radio frequencies, the access to and use of which are regulated by the FCC pursuant to the Communications Act of 1934, as amended. In general, a radio station license issued by the FCC is required in order to operate a radio transmitter. The FCC issues these licenses for a fixed term, and the licenses must be periodically renewed. Because of interference constraints, the FCC can generally issue only a limited number of radio station licenses for a particular frequency band in any one area.

Although radio licenses generally are required for radio stations, Part 15 of the FCC's rules permits certain low-power radio devices ("Part 15 devices") to operate on an unlicensed basis. Part 15 devices are designed to be used in frequencies licensed to and used by others. Such licensed users have preferential status within their respective frequencies. Part 15 devices are not permitted to cause harmful interference with such preferred uses and must be designed to accept interference from licensed radio devices. The Company's radio meter modules transmit in the 910-920 MHz band pursuant to these rules.

Itron's products are designed to eliminate virtually all interference with other frequency uses, while still enabling a complete and accurate "read" from its radio meter modules. However, if the Company were unable to eliminate harmful interference caused by its Part 15 devices through technical or other means, the Company or its customers could be required to cease operations in the band in the locations affected by the harmful interference. Further, in the event that the unlicensed frequencies used by the Company and its customers become unacceptably crowded or restrictive, and no additional frequencies are allocated, the Company's business could be materially adversely affected.

In late February 1997, the FCC adopted a Notice of Proposed Rulemaking seeking comments concerning the rules for multiple address systems. The Company uses licensed multiple address system frequencies to interrogate its meter modules. The FCC is proposing to change the method for licensing some multiple address system frequencies from individual site licenses to wide area licenses, and to conduct auctions for mutually exclusive applications in some multiple address frequency bands. The FCC has proposed to confine the use of the multiple address frequencies used by the Company to "private" use, and has instituted a freeze on accepting applications proposing to use the frequencies for nonprivate operations. The freeze does not affect license applications for private operations. Itron believes that its operations under outsourcing contracts qualify it as a private operator. Although the Company's customers generally hold the private operator licenses for the multiple address frequencies used in connection with the Company's products that the utility purchases, in limited instances the Company has applied to hold such licenses as a private carrier. The FCC's freeze will prevent the Company from applying for additional private carrier multiple address licenses while the FCC's rulemaking is pending. While the Company does not believe that the proposed changes to the method of licensing multiple address system frequencies will prevent it or its customers from obtaining necessary licenses, there can be no assurance that the rule changes will be adopted as proposed or that they will not have a material adverse effect on the ability of the Company or its customers to timely receive necessary licenses.

The Company also has been issued a renewable nationwide FCC license to operate in the 1427-1429 MHz band. With the exception of meter modules which operate in the 910-920 MHz band as described above, the Company's Fixed Network products operate within this band. This frequency band currently is under the exclusive control of the federal government, which has consented to the FCC's issuance of a license for Itron's use of the band. Current government use of the band is limited to a discrete number of well-defined locations, and the Company believes the secondary nature of its license does not have a material impact on its business.

The 1427-1429 MHz band is scheduled to be transferred from exclusive federal government jurisdiction to the FCC in 1998. The FCC has agreed to permit continued government use of the frequency through 2006, at which time the frequency could be subject to auction. To date, however, the FCC's approach has been to "grandfather" incumbent users and permit their continued operation, or, alternatively, to provide a period for incumbents to transition to other frequencies, with the auction winners having to compensate the incumbent users for relocation expenses. However, there can be no assurance that the FCC will follow precedent in this respect. The Company believes that it may have a significant installed base of products operating in the 1427-1429 MHz band by the time the band may become subject to auction. Consequently, the Company believes that it would be difficult for any potential bidder to overcome the public interest in the Company's continued use of the spectrum on behalf of utilities and that it likely would be cost-prohibitive for any potential bidder to provide compensation to the Company for relocation of the installed base. Further, the Company believes that commercial demand for the 1427-1429 MHz band is likely to be relatively low due to its proximity to a worldwide "exclusion zone" of radio astronomy frequencies that may not be used for any commercial purposes.

The regulatory environment the Company operates in is subject to change. There can be no assurance that the FCC or Congress will not take regulatory actions in the future that would have a material adverse effect on the Company. See "Certain Risk Factors--Availability and Regulation of Radio Spectrum." The Company is also subject to regulatory requirements in international markets. These regulations, which vary by country, require modifications to the Company's products, including operating on different frequencies with different power specifications.

#### MANUFACTURING

The Company manufactures meter modules, Fixed Network components and other AMR products, as well as handheld computers and peripheral equipment. The Company's primary manufacturing objective is to design and produce low-cost, high-quality meter modules and other Fixed Network components utilizing high-volume automation equipment. The Company's primary manufacturing facilities are located in Spokane, Washington and Waseca, Minnesota. The Company currently has the capacity to produce over 4.6 million meter modules annually on a two-shift basis. With the addition of a third shift and certain ancillary equipment, the Company has the capacity to produce 7.0 million meter modules annually. Certain of the Company's handheld system products and international meter module products are manufactured for the Company by third parties.

The Company's manufacturing operations are organized into three business units: Endpoint and Mobile Systems Operations; Network Systems Operations; and Handheld Operations. The Company recently combined its engineering and manufacturing departments, permitting its engineering and manufacturing staff to work more closely to enhance manufacturing efficiency and develop lower-cost product solutions.

The Company's Waseca manufacturing facility produces all of the Company's gas and water meter modules, data collection units used in Mobile AMR and handheld meter module installation and programming devices. The Company's Waseca operations are highly automated and designed for high-volume manufacturing requirements. The key processes include a ceramic board processing facility, automated surface mount placement equipment and both passive and active laser tuning equipment. The Waseca operation also is responsible for all of the Company's production of power supply subassemblies for electric meter modules and Mobile AMR systems products.

The Company's Spokane manufacturing facility was designed for manufacturing flexibility and automation, and is responsible for final assembly related to electric meter modules and CCU production. The key processes include automated surface mount placement equipment, laser tuning equipment and automated test capabilities. The Spokane facility is also responsible for manufacturing handheld systems and peripheral equipment, as well as other lower-volume AMR products, and is the primary repair facility for Itron's handheld systems products. In the first half of 1996, the Company expanded its manufacturing capacity in Spokane through the installation of high-speed automation and test equipment in order to support the anticipated growth in meter module and CCU production. Because this anticipated growth did not materialize, the Company currently has excess manufacturing capacity which has resulted in an increase in cost of sales per unit.

The Company has installed extensive automated testing equipment in both its manufacturing facilities to ensure quality control and process repeatability. The Company's testing includes both visual inspection and automated testing of technical parameters established for each of its products. The Company's quality control equipment also includes a sophisticated information system that collects data from its testing equipment and provides extensive reports and analyses of such data. This information system permits the Company to promptly identify potential problems or weaknesses in its manufacturing processes. The Company has been ISO 9000 certified since 1993 and received ISO 9002 recertification of

its Spokane facility in April 1996 and expects to receive ISO 9002 certification of its Waseca facility by 1998.

#### INDUSTRY SEGMENTS AND FOREIGN AND DOMESTIC OPERATIONS

The Company does not have any reportable industry segments other than foreign and domestic operations. Although the Company has two distinct product lines, AMR and Off-Site systems, they are not considered industry segments as there is commonality in all expenses associated with these product lines. Itron's foreign operations consist of three fully consolidated subsidiaries as well as international distributors. Subsidiary operations are located near Reading, England; Lyon, France; and Sydney, Australia. These offices are responsible for all utility sales and customer support within their respective countries. To reach the broader international market, the Company conducts sales through distributors appointed in approximately 45 other countries. See Note 12 of Notes to Consolidated Financial Statements.

#### BACKLOG OF ORDERS AND INVENTORY

The backlog of unshipped factory orders at the end of 1996 and 1995 was approximately \$72.8 million and \$71.9 million, respectively. The Company expects that all the orders in backlog at the end of 1996 will be shipped during 1997. In addition, the Company has multi-year contracts to supply radio meter modules and/or for outsourcing arrangements with several customers. The value of these contracts not included in the above backlog figures was \$240.3 million and \$66.8 million at December 31, 1996 and 1995, respectively. Inventories at December 31, 1996 and 1995 were \$33.4 million and \$18.1 million, respectively.

#### ENVIRONMENTAL REGULATIONS

Compliance with environmental regulations has not had a material effect on the Company's capital expenditures, earnings or competitive position.

#### EMPLOYEES

As of December 31, 1996, the Company employed 1,006 full-time persons; 394 in manufacturing, 244 in product development, 189 in sales and marketing, 83 in customer service and support and 96 in finance and administration. Of these employees, 48 were located in Europe, 30 in Australia and the remainder in the United States. The Company continues to recruit and seeks to maintain highly qualified management, marketing, technical and administrative personnel. None of the Company's employees is represented by a labor union. The Company has not experienced any work stoppages and considers its employee relations to be good.

#### OTHER

Itron does not have any contracts with the federal government. The Company's business is not significantly seasonal.

#### CERTAIN RISK FACTORS

This Annual Report on Form 10-K contains certain forward-looking statements. These forward-looking statements reflect management's best judgment based on factors known to them at the time of such statements, but are subject to a variety of risks and uncertainties, including, without limitation, those set forth below, many of which are beyond the Company's control, that could cause actual results to differ materially from those anticipated. The factors set forth below should be carefully considered when evaluating the Company's business and prospects and the forward-looking information provided by Itron pursuant to the safe harbor provisions established by recent securities legislation. See "--Certain Forward-Looking Statements."

Dependence on Utility Industry; Uncertainty Resulting From Mergers and Acquisitions and Regulatory Reform. The Company derives substantially all of its revenues from sales of its products and services to the utility industry. The Company has experienced variability of operating results on both an annual and a quarterly basis due primarily to utility purchasing patterns and delays of purchasing decisions as a result of mergers and acquisitions in the utility industry and changes or potential changes to the federal and state regulatory frameworks within which the electric utility industry operates.

The utility industry, both domestic and foreign, is generally characterized by long budgeting, purchasing and regulatory process cycles that can take up to several years to complete. The Company's utility customers typically issue requests for quotes and proposals, establish committees to evaluate the purchase, review different technical options with vendors, analyze performance and cost/benefit justifications and perform a regulatory review, in addition to applying the normal budget approval process within a utility. Purchases of the Company's products are, to a substantial extent, deferrable in the event that utilities reduce capital expenditures as a result of mergers and acquisitions, pending or unfavorable regulatory decisions, poor revenues due to weather conditions, rising interest rates or general economic downturns, among other factors.

The domestic electric utility industry is currently the focus of regulatory reform initiatives in virtually every state, which initiatives have resulted in significant uncertainty for industry participants and raised concerns regarding assets that would not be considered for recovery through ratepayer charges. Consequently, many utilities are delaying purchasing decisions that involve significant capital commitments. While the Company expects some states will act on these regulatory reform initiatives in the near term, there can be no assurance that the current regulatory uncertainty will be resolved in the near future or that the advent of new regulatory frameworks will not have a material adverse effect on the Company's business, financial condition and results of operations. Moreover, in part as a result of the competitive pressures in the utility industry arising from the regulatory reform process, many utility companies are pursuing merger and acquisition strategies. The Company has experienced considerable delays in purchase decisions by utilities that have become parties to merger or acquisition transactions. Typically, such purchase decisions are put on hold indefinitely when merger negotiations begin. The pattern of merger and acquisition activity among utilities may continue for the foreseeable future. If such merger and acquisition activity continues at its current rate or intensifies, the Company's revenues may continue to be materially adversely affected.

Certain state regulatory agencies are considering the "unbundling" of metering and certain other services from the basic transport aspects of the electricity distribution function. Unbundling includes the identification of the separate costs of metering and other services and may extend to subjecting metering and other services to competition. For example, the California Public Utilities Commission (the "CPUC") issued a draft opinion regarding the unbundling of metering, billing and related services. The discontinuance of a utility's metering monopoly could have a significant impact upon the manner in which the Company markets and sells its products and services. As the customer for the Company's products and services would change from utilities alone, to utilities and their competitive suppliers of metering services, the Company could also be required to modify its products and services (or develop new products and services) to meet the needs of the participants in a competitive meter services market.

Recent Operating Losses. The Company experienced operating losses in each of the past two quarters and expects to experience similar financial results in the first two quarters of 1997. There can be no assurance that the Company will thereafter achieve or maintain consistent profitability on a quarterly or annual basis. The Company has experienced variability of quarterly results and believes its quarterly results will continue to fluctuate as a result of factors such as size and timing of significant customer orders, delays in customer purchasing decisions, timing and levels of operating expenses, shifts in product or sales channel mix, and increased competition. Beginning in 1996, the Company increased its rate of spending on its Fixed Network AMR operations, which has left the Company subject to net operating losses caused by fluctuations in revenues. Recently, the Company's operating margins have been adversely affected by excess manufacturing capacity. The Company expects competition in the AMR market to increase as current competitors and new market entrants introduce competitive products. Operating margins also may be affected by other factors.

Customer Concentration. The Company's revenues in any particular year tend to be concentrated with a limited number of customers, the identity of which changes from year to year. In 1996, the Company had ten multi-year AMR contracts (excluding outsourcing contracts), which accounted for 44% of AMR revenues, or 33% of total Company revenues. One of these contracts was with Public Service Company of Colorado, and accounted for 22% of the Company's revenues in 1996. These contracts are subject to cancellation or rescheduling by customers. Cancellation or postponement of one or more of these contracts would have a material adverse effect on the Company. For example, beginning in the third quarter of 1996, the Company's revenues were adversely affected by an indefinite delay by a large customer in taking delivery of the Company's products pursuant to a multi-year contract. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Results of Operations" and "Description of Business--Customers."

Volatility of Share Price. The price of the Common Stock has traded in the range of \$14.50 to \$60.00 per share since January 1, 1996. The price of the Common Stock could continue to fluctuate significantly as a result of factors such as the Company's quarterly operating results, announcements by the Company or its competitors, changes in general conditions in the economy, the introduction of new products or technology, changes in earnings estimates by analysts or changes in the financial markets or the utility industry. In addition, in future quarters the Company's results of operations may be below the expectations of equity research analysts and investors, in which event the price of the Common Stock would likely be materially adversely affected. Further, in recent years the stock market has experienced significant price and volume fluctuations. These broad market fluctuations may materially adversely affect the market price of the Common Stock. See "Market for Registrant's Common Equity and Related Stockholder Matters."

Dependence on New Product Development. The Company has made and expects to continue to make a substantial investment in technology development. The Company's future success will depend in part on its ability to continue to design and manufacture new competitive products and to enhance its existing products and achieve large-scale implementation for its Fixed Network AMR products. This product development will require continued substantial investment in order to maintain the Company's market position. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Description of Business--Product Development." There can be no assurance that unforeseen problems will not occur with respect to the development, performance or market acceptance of the Company's technologies or products. Development schedules for high-technology products are subject to uncertainty, and there can be no assurance that the Company will meet its product development schedules. During 1996, and in previous years, the Company has experienced significant delays and cost overruns in the development of new products, and there can be no assurance that delays or cost overruns will not be experienced in the future. Delays in new product development, including software, can result from a number of causes, including changes in product definition during the development stage, changes in customer requirements, initial failures of products or unexpected behavior of products under certain conditions, failure of third-party supplied components to meet specifications or lack of availability of such components, unplanned interruptions caused by problems with existing products that can result in reassignment of product development resources, and other factors. Delays in the availability of new products or the inability to develop successfully products that meet customer needs could result in the loss of revenue or increased service and warranty costs, any of which would have a material adverse effect on the Company's business, financial condition and results of operations.

Dependence on the Installation, Operations and Maintenance of AMR Systems Pursuant to Outsourcing Contracts. A portion of the Company's business consists of outsourcing, wherein the Company installs, operates and maintains AMR systems that it continues to own in order to provide meter reading and other related services to utilities and their customers. The Company's long-term outsourcing contracts are subject to cancellation or termination in certain circumstances in the event of a material and continuing failure on the Company's part to meet contractual performance standards on a consistent basis over agreed time periods. The Company currently has three outsourcing contracts. The largest of the contracts, which is with Duquesne, involves Fixed Network AMR; the other two utilize a Mobile AMR solution.

The Duquesne Fixed Network AMR system is at this time only partially installed. Of a total of approximately 615,000 meter modules to be installed, approximately 240,000 were installed as of February 24, 1997. With respect to the Mobile AMR outsourcing contracts, installation of meter modules has been completed under one contract and has just commenced under the other contract. There can be no assurance that the Company will complete current installation requirements under the Duquesne Contract, the uncompleted Mobile AMR contract and any future outsourcing contracts.

The Company has experienced delays in performing its obligations under the Duquesne Contract. These delays relate primarily to the development of certain advanced meter reading functions and the software needed to complete these functions. While the Company is currently providing daily consumption meter data and tamper alarm capabilities for approximately 5,000 meters in Duquesne's service territory using its Fixed Network products, and has demonstrated additional advanced metering functions required under the Duquesne Contract, these additional functions are in a late development stage. While the Company believes that the next version of its Fixed Network AMR software will provide remaining advanced functions on a basis acceptable to Duquesne, and that it will complete the development of requisite capabilities to complete the installation of the AMR system specified in the Duquesne Contract in all material respects, there can be no assurance that it will be able to do so.

By the terms of the Duquesne Contract, the Company has not achieved the defined Phase I milestone. The Company believes that it has recently reached a verbal understanding with Duquesne regarding amendments to the Duquesne Contract pertaining to Phase I and other matters, which have not yet been agreed to in writing as contract amendments. Meter modules beyond the 5,000 modules originally specified in the Duquesne Contract for Phase I have been and are being installed without the benefit of a formal Duquesne Contract amendment. Given the large investment already made by the Company in meter modules and network equipment now installed at Duquesne, and the amount of revenues expected under the contract over its 15-year term, which is approximately \$150 million, the Company's financial condition would be materially adversely affected if Duquesne were to terminate the Duquesne Contract.

Increasing Competition. The Company faces competitive pressures from a variety of companies in each of the markets it serves. In the radio-based fixed network AMR market, companies such as CellNet currently offer alternative solutions to the utility industry and compete aggressively with the Company. The emerging market for fixed network AMR systems for the utility industry, together with the potential market for other applications once such fixed network systems are in place, have led communications, electronics and utility companies to begin developing various systems, some of which currently compete, and others of which may in the future compete, with the Company's Fixed Network AMR system. These competitors can be expected to offer a variety of technologies and communications approaches, as well as meter reading, installation and other services to utilities and other industry participants.

The Company believes that several large suppliers of equipment, services or technology to the utility industry have developed or are currently developing competitive products for the AMR market. For example, Schlumberger offers a competitive electric meter module for its newly manufactured meters and has entered into a joint venture with Motorola, Inc. for AMR product development. In addition, other large meter manufacturers could expand their current product and services offerings so as to compete directly with the Company. To stimulate demand, and due to increasing competition in the AMR market, the Company has from time to time lowered prices on its AMR products and may continue to do so in the future. The Company also anticipates increasing competition with respect to the features and functions of such products. In the handheld systems market, Itron has encountered competition from a number of companies, resulting in margin pressures in the maturing domestic handheld systems business.

Many of the Company's present and potential future competitors have substantially greater financial, marketing, technical and manufacturing resources, name recognition and experience than the Company. The Company's competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the development, promotion and sale of their products and services than the Company. In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties that increase their ability to address the needs of the Company's prospective customers.

Accordingly, it is possible that new competitors or alliances among current and new competitors may emerge and rapidly gain significant market share. There can be no assurance that the Company will be able to compete successfully against current and future competitors, and any failure to do so would have a material adverse effect on the Company's business, financial condition, results of operations and cash flow. See "Description of Business--Competition."

Uncertainty of Market Acceptance of New Technology. The AMR market is evolving, and it is difficult to predict the future growth rate and size of this market with any assurance. The AMR market did not grow as quickly in 1996 as the Company expected. Further market acceptance of the Company's new AMR products and systems, such as its Fixed Network products, will depend in part on the Company's ability to demonstrate cost effectiveness, and strategic and other benefits, of the Company's products and systems, the utilities' ability to justify such expenditures and the direction and pace of federal and state regulatory reform actions. In the event that the utility industry does not adopt the Company's technology or does not adopt it as quickly as the Company expects, the Company's future results will be materially and adversely affected. International market demand for AMR systems varies by country based on such factors as the regulatory and business environment, labor costs and other economic conditions. See "Description of Business--Sales, Distribution and Marketing."

Rapid Technological Change. The telecommunications industry, including the data transmission segment thereof, currently is experiencing rapid and dramatic technology advances. The advent of computer-linked electronic networks, fiber optic transmission, advanced data digitization technology, cellular and satellite communications capabilities, and private communications networks have greatly expanded communications capabilities and market opportunities. Many companies from diverse industries are actively seeking solutions for the transmission of data over traditional communications media, including radio-based and cellular telephone networks. Competitors may be capable of offering significant cost savings or other benefits to the Company's customers. There can be no assurance that technological advances will not cause the Company's technology to become obsolete or uneconomical.

Availability and Regulation of Radio Spectrum. A significant portion of the Company's products use radio spectrum and in the United States are subject to regulation by the FCC. In the past, the FCC has adopted changes to the requirements for equipment using radio spectrum, and there can be no assurance that the FCC or Congress will not adopt additional changes in the future. Licenses for radio frequencies must be renewed, and there can be no assurance that any license granted to the Company or its customers will be renewed on acceptable terms, if at all. The Company has committed, and will continue to commit, significant resources to the development of products that use particular radio frequencies. Action by the FCC could require modifications to the Company's products, and there can be no assurance that the Company would be able to modify its products to meet such requirements, that it would not experience delays in completing such modifications or that the cost of such modifications would not have a material adverse effect on the Company's future financial condition and results of operations.

The Company's radio-based products currently employ both licensed and unlicensed radio frequencies. There must be sufficient radio spectrum allocated by the FCC for the use the Company intends. As to the licensed frequencies, there is some risk that there may be insufficient available frequencies in some markets to sustain the Company's planned operations. The unlicensed frequencies are available for a wide variety of uses and are not entitled to protection from interference by other users. In the event that the unlicensed frequencies become unacceptably crowded or restrictive, and no additional frequencies are allocated, the Company's business will be materially adversely affected. See "Description of Business--FCC Regulation."

The Company is also subject to regulatory requirements in international markets that vary by country. To the extent the Company wishes to introduce products designed for use in the United States or another country into a new market, such products may require significant modification or redesign in order to meet frequency requirements and power specifications. Further, in some countries, limitations on frequency availability or the cost of making necessary modifications may preclude the Company from selling its products.

**Dependence on Key Personnel.** The Company's success depends in large part upon its ability to retain highly qualified technical and management personnel, the loss of one or more of whom could have a material adverse effect on the Company's business. The Company's success also depends upon its ability to continue to attract and retain highly qualified personnel in all disciplines. There can be no assurance that the Company will be successful in hiring or retaining the requisite personnel. See "Executive Officers of the Registrant."

**Intellectual Property.** While the Company believes that its patents, trademarks and other intellectual property have significant value, there can be no assurance that these patents and trademarks, or any patents or trademarks issued in the future, will provide meaningful competitive advantages. There can be no assurance that the Company's patents or pending applications will not be challenged, invalidated or circumvented by competitors or that rights granted thereunder will provide meaningful proprietary protection. Despite the Company's efforts to safeguard and maintain its proprietary rights, there can also be no assurance that such rights will remain protected or that the Company's competitors will not independently develop patentable technologies that are substantially equivalent or superior to the Company's technologies. See "Description of Business--Intellectual Property." On October 3, 1996, the Company brought an action in the United States District Court for the District of Minnesota against CellNet claiming infringement of one of Itron's patents. That action is pending, and the discovery phase thereof has commenced. There can be no assurance that the Company will prevail in such action or, even if it prevails, that the legal costs incurred by the Company in connection with such action will not have a material adverse effect on the Company's financial condition or results of operations. See "Legal Proceedings."

**Dependence on Key Vendors and Internal Manufacturing Capabilities.** Certain of the Company's products, subassemblies and components are procured from a single source, and others are procured only from limited sources. In particular, the Company currently obtains approximately 50% of its handheld devices from one vendor located in the United Kingdom and obtains all the microcontrollers for its AMR meter modules from a single source, National Semiconductor. The Company's reliance on such components or on these sole- or limited-source vendors or subcontractors involves certain risks, including the possibility of shortages and reduced control over delivery schedules, manufacturing capability, quality and costs. In addition, Itron may be affected by worldwide shortages of certain components, such as memory chips. A significant price increase in certain of such components or subassemblies could have a material adverse effect on the Company's results of operations. Although the Company believes alternative suppliers of these products, subassemblies and components are available, in the event of supply problems from the Company's sole- or limited-source vendors or subcontractors, the Company's inability to develop alternative sources of supply quickly or cost-effectively could materially impair the Company's ability to manufacture its products and, therefore, could have a material adverse effect on the Company's business, financial condition and results of operations. In the event of a significant interruption in production at the Company's manufacturing facilities, considerable time and effort could be required to establish an alternative production line. Depending on which production line were affected, such a break in production would have a material adverse effect on the Company's business, financial condition and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Results of Operations" and "Description of Business--Manufacturing."

Dependence on Outsourcing Financing. The Company intends to utilize limited recourse, long-term, fixed rate project financing for its future outsourcing contracts. It has established Itron Finance, Inc. as a wholly owned Delaware subsidiary and plans to establish bankruptcy remote, single and special purpose subsidiaries of Itron Finance, Inc. for this purpose. Although the Company has entered into a letter of intent and is in the process of negotiating definitive documents for what it believes to be the first AMR project financing, there can be no assurance that the Company will indeed close such financing or that it will be able to effect other project financings. If the Company is unable to utilize limited resource, long-term, fixed rate project financing for its outsourcing contracts, its borrowing capacity will be reduced and it may be subject to the negative effects of floating interest rates if it cannot hedge this exposure.

International Operations. International sales and operations may be subject to risks such as the imposition of government controls, political instability, export license requirements, restrictions on the export of critical technology, currency exchange rate fluctuations, generally longer receivables collection periods, trade restrictions, changes in tariffs, difficulties in staffing and managing international operations, potential insolvency of international dealers and difficulty in collecting accounts receivable. In addition, the laws of certain countries do not protect the Company's products to the same extent as do the laws of the United States. There can be no assurance that these factors will not have a material adverse effect on the Company's future international sales and, consequently, on the Company's business, financial condition and results of operations. See "Description of Business--Sales, Distribution and Marketing."

Control by Existing Shareholders and Antitakeover Considerations. Current executive officers and directors and their affiliates own or control in the aggregate approximately 20% of the outstanding Common Stock. As a result of such ownership, such persons may have significant influence over all matters requiring approval by the Company's shareholders, including the election of the Company's Board of Directors. The Company has the authority to issue 10 million shares of preferred stock in one or more series and to fix the powers, designations, preferences and relative, participating, optional or other rights thereof without any further vote or action by the Company's shareholders. The issuance of preferred stock could dilute the voting power of holders of Common Stock and could have the effect of delaying or preventing a change in control of the Company. Certain provisions of the Company's Restated Articles of Incorporation, Restated Bylaws, shareholder rights plan and employee benefit plans, as well as Washington law, may operate in a manner that could discourage or render more difficult a takeover of the Company or the removal of management or may limit the price certain investors may be willing to pay in the future for shares of Common Stock.

## ITEM 1a: EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the names, ages, titles with Itron, and principal occupations and employment for the last five years of the persons serving as executive officers of Itron as of March 1, 1997.

NAME ----	AGE ---	POSITION -----
Johnny M. Humphreys	59	President, Chief Executive Officer and Director
Carl Robert Aron	53	Executive Vice President and Chief Operating Officer
Stuart Edward White	46	President, Utility Translation Systems, Inc. and Director
Richard G. Geiger	47	Senior Vice President, Chief Technical Officer
Klaus O. Huschke	63	Senior Vice President, International
Robert D. Neilson	40	Senior Vice President, Strategy and Business Development
Michael J. O'Callaghan	57	Senior Vice President, Services
Larry A. Panattoni	58	Senior Vice President, Manufacturing
David G. Remington	55	Vice President and Chief Financial Officer
Russell E. Vanos	40	Vice President, Sales
LeRoy D. Nosbaum	50	Vice President, Marketing

Johnny M. Humphreys has been President, Chief Executive Officer and a director of Itron since 1987. From 1975 to 1986, Mr. Humphreys was employed by Datachecker Systems, Inc. ("Datachecker"), a subsidiary of National Semiconductor Corporation ("NSC"), in various executive positions, including President from 1980 to 1986. In 1986, Mr. Humphreys was appointed Senior Vice President of NSC's Information Systems Group and was responsible for strategic planning for three operating divisions, National Advanced Systems, Microcomputer Products Group and Datachecker.

Carl Robert Aron has been Executive Vice President and Chief Operating Officer of Itron since November 1995. Prior to joining Itron, Mr. Aron had been employed by EDS Management Consulting Services as the National Director of its Wireless Consulting Practice and its Utilities Telecommunications Practice since 1994. From 1981 to 1994, Mr. Aron was Chief Executive Officer of RAM Broadcasting Corporation, a provider of mobile communications services. From 1967 to 1990, Mr. Aron was an attorney with the law firm of Rubin Baum Levin Constant & Friedman.

Stuart Edward White joined Itron as President of Utility Translation Systems, Inc. in March 1996, when Itron acquired UTS. Mr. White has been a director of the Company since 1996. Mr. White has been President of UTS since its inception in 1980. Prior to founding UTS, Mr. White held numerous engineering and marketing management positions with Westinghouse Electric Corporation, Meter Division, for 13 years.

Richard G. Geiger was promoted to Senior Vice President and Chief Technology Officer of Itron in January 1996. Previously, Mr. Geiger had been Vice President, Product Development of Itron since 1993. From 1989 to 1992, Mr. Geiger was Vice President and General Manager of AMRplus Partners. From 1986 to 1989, Mr. Geiger was President of Mitsumi Technology, Inc., a research and development subsidiary of Mitsumi Company Limited, a developer of new electronics products. From 1984 to 1986, Mr. Geiger was Vice President and General Manager of Commodore Amiga, prior to which he spent four years with Apple Computer, Inc. as Manager of Advanced Development and four years with Digital Equipment Corporation.

Klaus O. Huschke was promoted to Senior Vice President, International of Itron in January 1996. Previously, Mr. Huschke had been Vice President, International of Itron since 1987. From 1982 to 1987, Mr. Huschke was Vice President, International Operations at Datachecker. Prior to joining Datachecker, he spent 21 years in a variety of sales and management positions with Anker Data Systems Corporation, a German point-of-sale manufacturer, in its German, Italian and American headquarters.

Robert D. Neilson was promoted to Senior Vice President, Strategy and Business Development of Itron in January 1996. Previously, Mr. Neilson had been Vice President, Marketing since 1993. Mr. Neilson joined Itron in 1983 as manager of market development and planning, and served as Director of Marketing from 1987 to 1993. As Director of Marketing, Mr. Neilson's responsibilities included marketing for AMRplus Partners.

Michael J. O'Callaghan was promoted to Senior Vice President, Service of Itron in July 1995. Mr. O'Callaghan joined Itron in 1987 as Vice President, Utility Systems. Before joining Itron, Mr. O'Callaghan was Vice President, Sales of NSC's microcomputer division. Prior to joining NSC, he was Vice President, Sales of Byvideo, Inc., a manufacturer of computer-based video kiosks for remote purchases. Prior to joining Byvideo, Inc., he was Vice President, Sales and Marketing of Onyx Systems, Inc., a manufacturer of UNIX-based microcomputers, for three years and was with NSC for nine years in various sales and marketing management positions.

Larry A. Panattoni was promoted to Senior Vice President, Manufacturing of Itron in January 1996. Mr. Panattoni joined Itron in 1990 as Vice President, Manufacturing. He previously spent 21 years in financial and operation management positions of increasing responsibility with NSC, most recently as Vice President of Administration. He was also Vice President of Manufacturing Operations and Administration, and Vice President of Finance and Administration with Datachecker.

David G. Remington joined Itron in early 1996 as Vice President and Chief Financial Officer. Before joining Itron, Mr. Remington was a Managing Director of Dean Witter Reynolds Inc. or Dean Witter Realty Inc. from 1988 to 1996. Previously, he spent 17 years with three financial services firms and a high technology firm. Immediately prior to Dean Witter Reynolds, he was Vice President-Finance and later President of Steiner Financial Corporation.

Russell E. Vanos has been Vice President, Sales of Itron since July 1995. Previously, Mr. Vanos had been the Western area sales director for Itron since 1988. Mr. Vanos joined Itron in 1980 as a field service representative installing the first generation of Itron EMR systems, and has served in numerous management positions with implementation, customer service and sales responsibilities.

LeRoy D. Nosbaum joined the Company as a Vice President in March 1996 and was named Vice President, Marketing in October 1996. Before joining Itron, Mr. Nosbaum was Executive Vice President and General Manager of Metricom, Inc.'s UtiliNet Division, and has held a variety of positions with Metricom since 1989. Prior to joining Metricom, Mr. Nosbaum was employed by Schlumberger Ltd. and Sangamo Electric for 20 years, most recently as General Manager of the Integrated Metering Systems Division of Electricity Management--North America, an operating group of Schlumberger.

## ITEM 2: PROPERTIES

The Company's headquarters are located in approximately 137,000 square feet of owned space in Spokane, Washington, including 60,000 square feet of manufacturing space. The Company also owns a building adjacent to its Spokane facility with approximately 28,000 square feet of manufacturing and engineering space. In Raleigh, North Carolina, the Company owns approximately 24,000 square feet used for all activities related to its UTS subsidiary. In Waseca, Minnesota, the Company leases 70,000 square feet of manufacturing and engineering space. The Company also has facilities in Saratoga, California; Lakeville, Minnesota; and Clearwater, Florida with approximately 80,000 square feet of total leased space. These facilities are used primarily for product development. The Company expects to consolidate its Clearwater operations with its operations in other locations and to close that facility in the second quarter of 1997. Additionally, the Company leases sales offices in the United Kingdom, France and Australia and in various cities throughout the United States. The Company's 1997 aggregate domestic and international base monthly lease obligation is approximately \$156,000. All the above facilities are in good condition and the Company believes that its current manufacturing and other properties will be sufficient to support its operations for the foreseeable future.

## ITEM 3: LEGAL PROCEEDINGS

On October 3, 1996, Itron filed a patent infringement suit against CellNet in the United States District Court for the District of Minnesota, claiming that CellNet is infringing on the Company's United States Patent No. 5,553,094, entitled "Radio Communication Network for Remote Data Generating Stations," issued on September 3, 1996. The Company is seeking injunctive relief as well as monetary damages, costs and attorneys' fees. CellNet filed a motion for a change of venue of the suit to the Northern District of California, which was denied in January 1997. The discovery phase of this lawsuit has commenced. There can be no assurance that the Company will prevail in this action or, even if it does prevail, that the legal costs incurred by the Company in connection therewith will not have a material adverse effect on the Company's financial condition. See "Certain Risk Factors--Intellectual Property."

The Company is not involved in any other material legal proceedings.

## ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of shareholders of Itron during the fourth quarter of fiscal 1996.

## ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

## MARKET INFORMATION FOR COMMON STOCK

Itron's Common Stock is traded on the Nasdaq National Market. The following table reflects the range of high and low closing sales prices for all four quarters of 1996 and 1995 as reported by the Nasdaq National Market.

	1996		1995	
	HIGH	LOW	HIGH	LOW
First Quarter	\$51.50	\$29.50	\$27.25	\$18.00
Second Quarter	\$60.00	\$27.75	\$33.50	\$22.50
Third Quarter	\$36.75	\$19.75	\$33.50	\$20.75
Fourth Quarter	\$26.00	\$14.50	\$34.50	\$23.50

## HOLDERS

At January 31, 1997, there were approximately 10,700 holders of record of the Company's Common Stock.

## DIVIDENDS

The Company has never declared or paid cash dividends. The Company intends to retain future earnings, if any, for the development of its business and does not anticipate paying cash dividends in the foreseeable future. Prior to the merger with the Company, UTS paid dividends of \$1,607,000, \$1,650,000 and \$200,000 in the years ended December 31, 1994, 1995 and 1996, respectively.

## ITEM 6: SELECTED FINANCIAL DATA

SELECTED CONSOLIDATED FINANCIAL INFORMATION  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEAR ENDED DECEMBER 31,				
	1996	1995	1994	1993	1992
STATEMENT OF OPERATIONS DATA					
Revenues					
AMR systems	\$ 132,500	\$ 100,383	\$ 65,009	\$ 43,679	\$ 32,531
Handheld systems	45,084	60,952	60,905	49,021	38,221
Total revenues	177,584	161,335	125,914	92,700	70,752
Cost of Revenues	104,708	89,596	69,481	49,527	37,165
Gross profit	72,876	71,739	56,433	43,173	33,587
Operating expenses					
Sales and marketing	28,847	20,054	17,159	13,353	11,547
Product development	33,285	27,080	18,071	12,619	10,018
General and administrative	10,970	7,589	5,727	5,260	4,793
Amortization of intangibles	1,542	2,336	2,266	2,240	855
Total operating expenses	74,644	57,059	43,223	33,472	27,213
Operating income (loss)	(1,768)	14,680	13,210	9,701	6,374
Equity in affiliates, interest & other	(366)	1,721	983	(555)	(4,302)
Income tax (provision) benefit	670	(5,250)	(3,930)	(3,110)	(815)
Income (loss) from continuing operations	(1,464)	11,151	10,263	6,036	1,257
Loss from discontinued operations and effect of accounting change, net	-	-	-	-	(1,408)
Net income (loss)	\$ (1,464)	\$ 11,151	\$ 10,263	\$ 6,036	\$ (151)
PER SHARE DATA					
Income (loss) from continuing operations	\$ (.11)	\$ .81	\$ .80	\$ .59	\$ .13
Loss from discontinued operations and effect of accounting change, net					(.15)
Net income (loss)	\$ (.11)	\$ .81	\$ .80	\$ .59	\$ (.02)
Weighted average shares outstanding	13,297	13,775	12,851	10,234	9,464
BALANCE SHEET DATA					
Working capital	\$ 26,239	\$ 64,536	\$ 63,357	\$ 43,784	\$ 4,813
Total assets	187,421	149,718	122,333	102,076	66,068
Total debt	39,591	5,668	391	1,284	11,446
Shareholders' equity	114,222	111,273	97,477	73,735	37,242

All amounts have been restated to give effect to a pooling of interests consummated in March 1996. See Note 6 of Notes to Consolidated Financial Statements.

## ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with "Selected Consolidated Financial Information" and the Company's Consolidated Financial Statements and Notes thereto.

## OVERVIEW

Itron is a leading global provider to the utility industry of data acquisition and wireless communications solutions for collecting, communicating and analyzing electric, gas and water usage. The Company designs, develops, manufactures, markets, installs and services hardware, software and integrated systems for utilities to obtain, analyze and use meter information. The Company's product lines include AMR systems, EMR systems, and specialized software applications. The Company both sells its products and provides outsourcing services.

The Company's AMR solutions involve the use of radio and, in some instances, telephone technology, to collect meter data. The Company's radio-based AMR solutions include Off-Site AMR, Mobile AMR and Fixed Network AMR technology reading options. Off-Site AMR utilizes a radio device attached to an Itron handheld computer that interrogates meters equipped with radio meter modules from up to 800 feet away. Mobile AMR uses a transceiver mounted in a vehicle to collect data from meters equipped with radio meter modules. Fixed Network AMR collects and transmits meter information via radio components that are mounted in a variety of fixed locations. Outsourcing services encompass the installation, operation and maintenance of an AMR system to provide meter information to a utility for billing and management purposes. Outsourcing contracts typically cover long timeframes, such as 15 years. The Company recognizes revenues and expenses relating to outsourcing contracts using long-term contract accounting. The Company's Off-Site AMR systems product line includes ruggedized handheld computers to record visually obtained meter data, and supporting products and services.

In March 1996, the Company merged with UTS, the leading provider in the United States of software systems for metering data acquisition and analysis for the large commercial and industrial customers of electric and gas utilities. The merger has been accounted for as a pooling of interests, and all prior period amounts have been restated to give effect to the combined financial position and operating results of Itron and UTS.

The Company derives substantially all of its revenues from sales of its products and services to the utility industry. The Company has experienced variability of operating results on both an annual and a quarterly basis due primarily to utility purchasing patterns and delays of purchasing decisions as a result of mergers and acquisitions in the utility industry and changes or potential changes to the federal and state regulatory frameworks within which the electric utility industry operates.

## RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain statements of operations data as a percentage of revenues, and the year-to-year percentage change.

	PERCENTAGE OF TOTAL REVENUES			PERCENTAGE CHANGE	
	YEAR ENDED DECEMBER 31,			1995	1996
	1994	1995	1996	OVER 1994	OVER 1995
Revenues:					
AMR systems .....	52%	62%	75%	54%	32%
Handheld systems .....	48%	38%	25%	0%	(26)
	---	---	---		
Total revenues .....	100%	100%	100%	28%	10%
Gross profit .....	45%	44%	41%	27%	2%
Operating expenses:					
Sales and marketing .....	14%	12%	16%	17%	44%
Product development .....	14%	17%	19%	50%	23%
General and administrative	4%	5%	6%	33%	45%
Amortization of intangibles	2%	1%	1%	3%	(34)
	---	---	---		
Total operating expenses	34%	35%	42%	32%	31%
Operating income .....	11%	9%	(1)	11	(112)

Revenues. Total revenues increased \$16.2 million, or 10%, to \$177.6 million in 1996 compared to \$161.3 million in 1995. AMR systems revenues increased \$32.1 million, or 32%, in 1996 over the prior year due to higher shipped volumes of AMR meter modules. The increased shipped volume resulted from the addition of 88 new AMR customers in 1996, as well as accelerated installation schedules for a significant customer, PSCo. PSCo accounted for 30% of AMR revenues (or 22% of total revenues) in 1996 compared to 22% of AMR revenues (or 14% of total revenues) in 1995. Excluding shipments for outsourcing contracts, the Company shipped 2.1 million AMR meter modules in 1996 compared to 1.5 million the previous year. Average selling prices in 1996 for AMR meter modules declined from 1995 due to changes in product mix, OEM sales and volume discounting. AMR system revenues increased \$35.4 million, or 54%, in 1995 over 1994. Shipments of AMR meter modules in 1995 increased more than 50% over 1994 due to an increase of 79 new AMR customers and significant shipments to PSCo. During 1996, the Company had ten multi-year sales contracts (excluding outsourcing contracts) to supply AMR systems to utilities at specified prices. Revenues related to multi-year sales contracts represented 44% of AMR revenues in 1996 compared to 56% in 1995 and 66% in 1994. These contracts are subject to cancellation and rescheduling. Any delay or cancellation of such contracts could materially adversely affect the Company's revenues in the future.

The Company currently has three outsourcing contracts. The largest of these is a Fixed Network AMR installation and the other two utilize Mobile AMR solutions. Revenues from these contracts were insignificant in 1995 and 1996 and are included as a component of AMR system revenues. The Company believes that outsourcing revenues in 1997 will represent a larger share of total revenues. See "Certain Risk Factors--Dependence on the Installation, Operations and Maintenance of AMR Systems Pursuant to Outsourcing Contracts."

The Company believes that AMR revenues will continue to grow in the future. However, this growth depends upon the timing and resolution of mergers and acquisitions in the utility industry, industry regulatory reform issues in the United States, development of international markets and other factors. See

"Description of Business--Overview of Current Environment in the Utility Industry" and "Certain Risk Factors--Dependence on Utility Industry; Uncertainty Resulting From Mergers and Acquisitions and Regulatory Reform."

Handheld systems revenues for 1996 declined \$15.9 million, or 26%, from 1995 due to large system sales to two Japanese utilities in 1995, which represented over 23% of total handheld system sales. Handheld systems revenues of approximately \$61.0 million remained relatively stable from 1994 to 1995. International revenues, which consist primarily of handheld systems, represented only 8% of total revenues in 1996 compared to 17% of total revenues in the previous year. The Company believes that revenues for handheld systems will continue to decline as a percentage of total revenues. Future handheld systems revenues are expected to be generated primarily from upgrade and replacement business domestically, and from further penetration into international markets. International revenues have historically been uneven from period to period and the Company expects that this pattern will continue in the future.

Gross Profit. Gross profit in 1996 declined to 41% of revenues from 44% of revenues in 1995 primarily due to excess manufacturing capacity added during 1996, as well as a change in product mix. Manufacturing capacity was added in anticipation of an increase in demand for the Company's AMR products in excess of what was realized. Gross profit in the future may be affected by the terms of outsourcing arrangements entered into by the Company and by the risks inherent in cost estimation under the long-term method of contract accounting. In particular, the Company expects that gross profit during the first half of 1997 will be reduced due to a higher proportion of revenues from outsourcing. Gross profit remained level at 44% to 45% of revenues in 1995 and 1994.

Operating Expenses. Sales and marketing expenses for 1996 of \$28.8 million increased both in total and as a percentage of revenues to 16% in 1996 from 12% in 1995. The year-to-year growth is primarily due to expansion of technical sales and implementation staff for Fixed Networks. Also driving the increase was the reorganization of the Company's sales and marketing staff, including the functions performed by the Genesis Services division. Sales and marketing expenses in 1995 increased \$2.9 million, or 17%, from 1994, but decreased as a percentage of revenues to 12% in 1995 from 14% in 1994. The higher expenses in 1995 resulted from enhanced marketing efforts for the Company's AMR business. The Company expects sales and marketing expenses in 1997 to remain at levels comparable to 1996.

Product development expenses increased \$6.2 million in 1996, or 23%, over 1995 and increased as a percentage of revenues from 17% to 19%. Product development expenses increased \$9.0 million in 1995, or 50% over 1994, and increased as a percentage of revenues from 14% to 17%. The higher spending in 1995 and 1996 was due to accelerated development of Fixed Network AMR products such as network management software, applications software, cell control units, network integration and testing, development of water and international meter modules and continued cost reduction programs. In addition, in 1996 the Company incurred \$2.1 million in one-time charges for materials related to the redesign of the cell control unit and a new handheld computer. The Company expects that the increased level of development expenses in 1996 will continue but will begin to gradually decrease as a percentage of revenue over the long term.

General and administrative expenses increased \$3.4 million, or 45%, from 1995 to 1996 but remained fairly stable as a percentage of revenues at 6% compared to 5% in 1995. The 1996 increase was related to operating and maintenance expenses associated with expanded facilities, executive staff additions and third quarter severance charges related to a 5% reduction in the Company's workforce. General and administrative expenses increased \$1.9 million, or 33%, from 1994 to 1995 due to investments in the Company's corporate training and development efforts combined with filling the newly created position of Chief Operating Officer in late 1995.

Interest and Other. Gross interest expense for 1996 was \$1.4 million and was the result of borrowings under the Company's revolving line of credit. Interest on long-term mortgages also contributed to the expense. The Company's capitalized interest expense of \$533,000 in 1996 primarily related to outsourcing. Net interest income for 1995 was \$878,000 more than for 1994 due to a higher level of investments during the year. Average investments in 1995 were approximately \$20.0 million higher than in 1994 as a result of continued positive cash flows from operations and remaining cash from the Company's two public stock offerings.

Income Taxes. The income tax benefit for 1996 was 31% of the pre-tax loss. This effective rate was lower because foreign operating losses for which no tax benefit has been recorded and a cash-to-accrual accounting adjustment related to the merger with UTS. The reported effective income tax rate for 1995 and 1994 was 32% and 28%, respectively, which is lower than the pro forma rate because UTS was taxed as an S corporation prior to the merger. The pro forma effective income tax rate for 1995 and 1994 was calculated using the Company's effective tax rate for each year. The Company's effective income tax rate may vary from year to year because of fluctuations in foreign operating results, changes in tax jurisdictions in which the Company operates, and changes in tax legislation.

#### FINANCIAL CONDITION

During the first three quarters of 1996, the Company made large investments in inventory. Cash used by operating activities in the first three quarters of 1996 was \$7.9 million, \$3.1 million and \$12.6 million. In contrast, in the fourth quarter operating activities provided cash of \$6.8 million as investments in inventory were curtailed. In the fourth quarter of 1996, the Company revised its production schedules from "build to expectation" to "build to order," which is expected to improve inventory turnover in the future.

During the first three quarters of 1996, the Company also substantially increased its manufacturing capacity. Quarterly acquisitions of property, plant and equipment declined from \$7.6 million, \$7.9 million and \$9.5 million in the first, second and third quarters, respectively, to \$2.5 million in the fourth quarter of 1996 as the Company completed its manufacturing expansion. Additionally, investments in outsourcing equipment increased from \$827,000 in the first quarter of 1996 to \$10.9 million in the fourth quarter.

Working capital at December 31, 1996 was \$26.2 million compared to \$64.5 million at December 31, 1995. The significant decline in 1996 was caused by investments in manufacturing capacity and outsourcing equipment, which were funded by cash and bank borrowings. Bank borrowings at December 31, 1996 were \$33.1 million compared to cash and short-term investments of \$31.5 million at December 31, 1995. In January 1997, the Company expanded its revolving line of credit from \$50 million to \$75 million through its expiration on May 31, 1997.

Net operating activities consumed \$16.9 million in cash in 1996 compared with providing \$11.2 million in cash in 1995 and \$15.6 million in 1994. Most of the 1996 cash consumption was driven by growth in inventories, which were built in anticipation of Fixed Network AMR customer orders in excess of what was realized and for delivery under outsourcing arrangements. The decreased cash generated from operations in 1995 compared to 1994 was also primarily due to increased accounts receivable and inventories. In 1995, the Company intentionally built its inventory of AMR meter modules in order to meet projected demand levels and transition to a new AMR meter module manufacturing line in the first half of 1996.

Investing activities, excluding changes in short-term investments, consumed \$49.9 million of cash in 1996 compared to \$23.1 million and \$11.1 million in 1995 and 1994, respectively. Additions to

production capacity accounted for approximately \$20.0 million of \$27.5 million in full-year 1996 capital additions. The Company substantially completed its capacity expansion program in the fourth quarter of 1996. Current production capacity is about 4.5 million AMR meter modules annually on a two-shift basis. The Company believes its AMR meter module capacity is sufficient for 1997. Capital acquisitions in 1997 are expected to be approximately one-half of the 1996 level. Equipment used in outsourcing contracts required \$17.3 million in cash in 1996. The Company expects to use a similar amount for outsourcing in 1997. Other investing activities in 1996 consisted of the acquisition of Fixed Network AMR patents and technologies. Capital asset additions were \$16.6 million in 1995 and included the purchase of new surface mount lines for each of the Company's manufacturing locations and \$2.4 million for the purchase of the Company's manufacturing and headquarters facility in Spokane.

Financing activities for 1996 provided \$37.5 million in cash and consisted principally of borrowings under the bank line of credit agreement as well as funds received from the exercise of employee stock options and the related tax benefit. Net cash provided by financing activities in 1995 was \$1.7 million compared to \$12.1 million in 1994. Financing activities during 1995 consisted of cash proceeds of \$1.4 million from the exercise by the underwriters of an over-allotment option of 75,000 shares related to a public stock offering by the Company in December 1994 and \$2.3 million from the exercise of employee stock options and the related tax benefit. The Company received net proceeds of \$10.9 million in 1994 from the follow-on public stock offering.

The Company believes its existing cash, together with renewal of its credit facility at its current level, will be adequate to fund its operations for the remainder of 1997. While the Company expects the credit facility to be renewed in the ordinary course, there can be no assurance that it will be renewed, or will be renewed on terms acceptable to the Company or at sufficient levels. The Company expects to finance future outsourcing contracts by means of project financing.

The Company is actively considering long-term financing alternatives, which may take the form of debt, equity-linked securities, common stock or a combination of the foregoing. The Company expects that it will complete one of these financings during the first half of 1997.

## CERTAIN FORWARD-LOOKING STATEMENTS

When included in this Annual Report on Form 10-K, the words "expects," "intends," "anticipates," "plans," "projects" and "estimates," and analogous or similar expressions are intended to identify forward-looking statements. Such statements, which include, but are not limited to, statements contained in "Business," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Certain Risk Factors," are inherently subject to a variety of risks and uncertainties that could cause actual results to differ materially from those reflected in such forward-looking statements. Such risks and uncertainties include, among others, changes in the utility regulatory environment, delays or difficulties in introducing new products, increased competition and various other matters, many of which are beyond the Company's control. These forward-looking statements speak only as of the date of this report. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any change on the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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## INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders of Itron, Inc.  
Spokane, Washington

We have audited the accompanying consolidated balance sheets of Itron, Inc. and subsidiaries as of December 31, 1996 and 1995 and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The consolidated financial statements give retroactive effect to the merger of the Company and Utility Translation Systems, Inc. (UTS), which has been accounted for as a pooling of interests as described in Note 6 to the consolidated financial statements. We did not audit the balance sheet of UTS as of December 31, 1995, or the related statements of operations, shareholders' equity, and cash flows of UTS for the years ended December 31, 1995 and 1994, which statements reflect total assets of \$2,694,610 as of December 31, 1995, and total revenues of \$5,984,589 and \$5,255,379 for the years ended December 31, 1995 and 1994, respectively. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for UTS for 1995 and 1994, is based solely on the report of such other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, such consolidated financial statements present fairly, in all material respects, the financial position of Itron, Inc. and subsidiaries at December 31, 1996 and 1995 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Seattle, Washington  
February 7, 1997

The Board of Directors and Shareholders  
Utility Translation Systems, Inc.

We have audited the balance sheet of Utility Translation Systems, Inc. as of December 31, 1995 and the related statements of income, shareholders' equity and cash flows for the years ended December 31, 1995 and 1994. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Utility Translation Systems, Inc. at December 31, 1995 and the results of its operations and its cash flows for the years ended December 31, 1995 and 1994 in conformity with generally accepted accounting principles.

Ernst & Young LLP

February 28, 1996 except for Note 8  
as to which the date is March 25, 1996

## ITRON, INC.

CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE DATA)

	DECEMBER 31,	
	1996	1995
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 2,243	\$ 6,473
Short-term investments.....	--	25,074
Accounts receivable, net.....	44,376	38,015
Inventories.....	33,837	18,065
Deferred income tax benefit, net.....	4,171	4,531
Other.....	6,116	1,388
	-----	-----
Total current assets.....	90,743	93,546
	-----	-----
Property, plant and equipment, net.....	71,349	34,137
Intangible assets, net.....	22,328	20,230
Other.....	3,001	1,805
	-----	-----
Total assets.....	\$187,421	\$149,718
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Bank line of credit.....	\$ 33,062	\$ --
Accounts payable and accrued expenses.....	20,671	16,290
Wages and benefits payable.....	4,004	4,514
Deferred revenue.....	6,767	8,206
	-----	-----
Total current liabilities.....	64,504	29,010
	-----	-----
Notes payable.....	6,440	5,600
Warranty and other obligations.....	2,255	2,160
Deferred income taxes, net.....	--	1,675
	-----	-----
Total liabilities.....	73,199	38,445
	-----	-----
Commitments (Note 7).....	--	--
Shareholders' equity:		
Common stock, no par value, 75 million shares authorized, 13,387,042 and 13,157,263 shares issued and outstanding.....	98,686	94,108
Warrants.....	338	338
Other.....	(107)	(142)
Retained earnings.....	15,305	16,969
	-----	-----
Total shareholders' equity.....	114,222	111,273
	-----	-----
Total liabilities and shareholders' equity.....	\$187,421	\$149,718
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

## ITRON, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS  
 (IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Revenues.....	\$177,584	\$161,335	\$125,914
Cost of revenues.....	104,708	89,596	69,481
Gross profit.....	72,876	71,739	56,433
Operating expenses:			
Sales and marketing.....	28,847	20,054	17,159
Product development.....	33,285	27,080	18,071
General and administrative.....	10,970	7,589	5,727
Amortization of intangibles.....	1,542	2,336	2,266
Total operating expenses.....	74,644	57,059	43,223
Operating income (loss).....	(1,768)	14,680	13,210
Interest and other, net.....	(366)	1,721	983
Income (loss) before income taxes.....	(2,134)	16,401	14,193
Income tax (provision) benefit.....	670	(5,250)	(3,930)
Net income (loss).....	\$ (1,464)	\$ 11,151	\$ 10,263
Net income (loss) per common share.....	\$ (.11)	\$ .81	\$ .80
Weighted average shares outstanding.....	13,297	13,775	12,851

The accompanying notes are an integral part of these consolidated financial statements.

## ITRON, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(IN THOUSANDS)

	COMMON STOCK		WARRANTS	OTHER	RETAINED EARNINGS (DEFICIT)
	SHARES	AMOUNT			
Balances at December 31, 1993.....	11,672	\$75,894	\$ 798	\$ (1,768)	\$ (1,188)
Net income.....	--	--	--	--	10,263
Stock issues:					
Public offering.....	304	5,097	--	--	--
Options exercised and related tax benefits.....	388	3,735	--	--	--
Employee savings plan.....	10	185	--	--	--
Proceeds from note receivable.....	--	--	--	983	--
Warrants exercised.....	536	5,275	(460)	--	--
Dividends paid.....	--	--	--	--	(1,607)
Unrealized loss on investments.....	--	--	--	(78)	--
Foreign currency translation.....	--	--	--	348	--
Balances at December 31, 1994.....	12,910	90,186	338	(515)	7,468
Net income.....	--	--	--	--	11,151
Stock issues:					
Public offering.....	75	1,351	--	--	--
Options exercised and related tax benefits.....	161	2,291	--	--	--
Employee savings plan.....	11	280	--	--	--
Dividends paid.....	--	--	--	--	(1,650)
Unrealized gain on investments.....	--	--	--	236	--
Foreign currency translation.....	--	--	--	137	--
Balances at December 31, 1995.....	13,157	94,108	338	(142)	16,969
Net loss.....	--	--	--	--	(1,464)
Stock issues:					
Options exercised and related tax benefits.....	199	3,480	--	--	--
Employee savings plan.....	23	670	--	--	--
Employee stock purchase plan.....	8	428	--	--	--
Dividends paid.....	--	--	--	--	(200)
Unrealized loss on investments.....	--	--	--	(158)	--
Foreign currency translation.....	--	--	--	193	--
Balances at December 31, 1996.....	13,387	\$98,686	\$ 338	\$ (107)	\$ 15,305

The accompanying notes are an integral part of these consolidated financial statements.

## ITRON, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
<b>OPERATING ACTIVITIES</b>			
Net income (loss).....	\$ (1,464)	\$ 11,151	\$ 10,263
Noncash charges (credits) to income:			
Depreciation and amortization.....	10,522	8,370	6,929
Deferred income tax provision (benefit).....	(1,545)	758	880
Changes in operating accounts, net of acquisitions:			
Accounts receivable.....	(6,361)	(9,659)	(3,557)
Inventories.....	(15,772)	(5,509)	3,445
Accounts payable and accrued expenses.....	4,381	3,935	(1,255)
Deferred revenue.....	(1,439)	857	(2,312)
Other, net.....	(5,184)	1,323	1,239
Cash provided (used) by operating activities.....	(16,862)	11,226	15,632
<b>INVESTING ACTIVITIES</b>			
Change in short-term investments, net.....	25,074	5,614	(17,869)
Acquisition of property, plant and equipment.....	(27,500)	(16,584)	(7,327)
Equipment used in outsourcing.....	(17,254)	(2,396)	--
Acquisitions and investment in affiliates.....	(4,728)	(3,808)	--
Capitalized software.....	--	(62)	(3,144)
Other, net.....	(441)	(221)	(634)
Cash used by investing activities.....	(24,849)	(17,457)	(28,974)
<b>FINANCING ACTIVITIES</b>			
Change in bank line of credit, net.....	33,062	--	--
Issuance of common stock.....	4,578	3,642	13,647
Proceeds from employee note receivable.....	--	--	983
Dividends paid.....	(200)	(1,650)	(1,607)
Other, net.....	41	(288)	(954)
Cash provided by financing activities.....	37,481	1,704	12,069
Decrease in cash and cash equivalents.....	(4,230)	(4,527)	(1,273)
Cash and cash equivalents at beginning of period.....	6,473	11,000	12,273
Cash and cash equivalents at end of period.....	\$ 2,243	\$ 6,473	\$ 11,000

The accompanying notes are an integral part of these consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## BUSINESS

Itron, Inc. (the "Company") is a leading global provider to the utility industry of data acquisition and wireless communications solutions for collecting, communicating and analyzing electric, gas and water usage. The Company designs, develops, manufactures, markets, installs and services hardware, software and integrated systems for handheld computer-based electronic meter reading (EMR), automatic meter reading (AMR) and other measurement systems.

## BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of Itron, Inc. and its wholly owned subsidiaries. As described in Note 6, on March 25, 1996, Utility Translation Systems, Inc. (UTS), which was acquired in a pooling-of-interests transaction, became a wholly owned subsidiary of the Company. These consolidated financial statements reflect the combined financial position and operating results of the Company and UTS for all periods presented. All significant intercompany transactions and balances are eliminated. Investments in affiliates are accounted for using the equity method.

## CASH AND CASH EQUIVALENTS

The Company considers all highly liquid instruments with original maturities of three months or less to be cash equivalents. Cash equivalents are recorded at cost, which approximates fair value.

## SHORT-TERM INVESTMENTS

The Company's short-term investments are classified as available-for-sale and are recorded at market value. Investments are accounted for on a trade date basis and market value is based upon quoted market prices for each security. Realized gains and losses are determined on a security by security basis (the specific identification method). Unrealized holding gains and losses, net of any tax effect, are recorded as a component of shareholders' equity (see Note 2).

## INVENTORIES

Inventories are stated at the lower of cost or market using the first-in, first-out method. Cost includes raw materials and labor, plus applied overhead. Service inventories consist primarily of subassemblies and components necessary to support service operations.

## PROPERTY, PLANT AND EQUIPMENT

Property and equipment are stated at cost and are depreciated over their estimated useful lives of three to seven years, or over the term of the applicable capital lease, if shorter, using the straight-line method. Equipment used in outsourcing contracts is depreciated using the straight-line method over the shorter of the useful life or the term of the contract, generally 15 years. Plant is depreciated over 30 years using the straight-line method. The carrying value of property, plant and equipment is reviewed on a regular basis for impairment. The Company capitalizes interest as a component of the cost of property, plant and equipment constructed for its own use in outsourcing contracts. In 1996, total interest expense was \$1.4 million, of which \$533,000 was capitalized. There was no interest capitalized in 1995 or 1994.

## INTANGIBLE ASSETS

Goodwill represents the excess cost of acquired businesses over the fair value of their net assets and is amortized using the straight-line method over periods ranging from three to twenty years. Patents, distribution and product rights are amortized using the straight-line method over their remaining lives of three to seventeen years. Capitalized software includes costs incurred subsequent to the establishment of technological feasibility of

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

the related product and is amortized using the straight-line method for a period not to exceed five years. Management regularly reviews the carrying value of intangible assets for impairment.

## WARRANTY

The Company offers standard warranty terms on its product sales. Provision for estimated warranty costs is recorded at the time of sale and periodically adjusted to reflect actual experience. The noncurrent warranty reserve covers future expected costs of the testing and replacement of radio meter modules. Warranty expense was \$3.1 million in 1996, \$1.8 million in 1995 and \$836,000 in 1994.

## INCOME TAXES

The Company accounts for income taxes under the asset and liability method. Under this method, deferred income taxes are recorded for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. These deferred taxes are measured by the provisions of currently enacted tax laws. Management believes that it is more likely than not that the Company will generate sufficient taxable income to allow the realization of the net deferred tax asset.

## FOREIGN EXCHANGE

The consolidated financial statements are prepared in U.S. dollars. Assets and liabilities of foreign subsidiaries are denominated in foreign currencies and are translated into U.S. dollars at the exchange rates in effect on the balance sheet date. Revenues, costs and expenses for these subsidiaries are translated using an average rate. Translation adjustments resulting from this process are a component of shareholders' equity.

## REVENUE RECOGNITION

Revenues from hardware sales and software licenses are generally recognized upon shipment. For large custom systems and outsourcing contracts, revenue is recognized using the cost-to-cost, percentage of completion, long-term contract method of accounting. Contract costs include direct labor and other costs related to contract performance such as materials, repairs and depreciation costs. Service revenues are recognized ratably over the periods covered by the service contracts, or as the services are performed. Revenues for shipments or services not yet billed are included in accounts receivable or other noncurrent assets depending on the expected period of collection. Deferred revenue is recorded upon billing for products or services which have not yet been provided.

## NET INCOME PER COMMON SHARE

Primary net income per common share is computed based on the weighted average number of common equivalent shares outstanding during the period as adjusted for the stock issued in the merger with UTS, as described in Note 6, and after consideration of the dilutive effect, if any, of the common stock equivalents using the treasury stock method. Common equivalent shares include shares issuable upon exercise of stock options and warrants. The number of shares used in the computation was 13,297,000 in 1996, 13,775,000 in 1995 and 12,851,000 in 1994. Fully diluted net income per share was \$.80 and \$.79 in 1995 and 1994, respectively. Shares used in the fully diluted computation were 13,932,000 and 12,933,000 in 1995 and 1994, respectively. Fully diluted net income per share was not presented for the year ended December 31, 1996 because common stock equivalents are excluded from the calculation in the year of a loss.

## USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## FINANCIAL INSTRUMENTS FAIR VALUE

The carrying value of cash and cash equivalents reflected in the balance sheet at December 31, 1996 reasonably approximates the fair value of such instruments. Based on the rates currently available to the Company for loans with similar terms and maturities, the Company believes that the fair value of the notes payable reasonably approximates their carrying values at December 31, 1996.

## RECLASSIFICATIONS

Certain amounts in the 1995 and 1994 financial statements have been reclassified to conform with the 1996 presentation.

## NOTE 2: SHORT-TERM INVESTMENTS

Short-term investments at December 31, 1995 consist of investment-grade, tax-exempt state and municipal notes and bonds. The Company had no short-term investments at December 31, 1996. Information related to such investments follows (in thousands):

	AT DECEMBER 31,	
	1996	1995
Market value.....	\$ --	\$25,074
Cost.....	--	24,916

	YEAR ENDED DECEMBER 31,	
	1996	1995
Unrealized holding gains.....	\$ --	\$ 159
Unrealized holding losses.....	--	(1)
Realized gains.....	117	59
Realized losses.....	(11)	130

Proceeds from the sale of investment securities for the year ended December 31, 1996 were \$24.5 million.

## NOTE 3: BALANCE SHEET COMPONENTS

## ACCOUNTS RECEIVABLE (IN THOUSANDS):

	AT DECEMBER 31,	
	1996	1995
Trade (net of allowance for doubtful accounts of \$752 and \$509)....	\$30,764	\$28,847
Unbilled revenue.....	13,612	9,168
Total receivables.....	\$44,376	\$38,015
	=====	=====

Other noncurrent assets at December 31, 1996 includes \$1.2 million of unbilled revenue related to long-term contracts. This amount is expected to be billed in 1997 and 1998.

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

## INVENTORIES (IN THOUSANDS):

	AT DECEMBER 31,	
	1996	1995
Material.....	\$ 22,687	\$ 9,594
Work in process.....	1,570	555
Finished goods.....	9,047	7,433
Total manufacturing inventories.....	33,304	17,582
Service inventories.....	533	483
Total inventories.....	\$ 33,837	\$ 18,065

## PROPERTY, PLANT AND EQUIPMENT (IN THOUSANDS):

	AT DECEMBER 31,	
	1996	1995
Machinery and equipment.....	\$ 37,715	\$ 21,101
Equipment used in outsourcing.....	19,650	2,396
Computers and purchased software.....	21,535	19,233
Buildings, furniture and improvements.....	20,345	14,015
Land.....	2,078	1,659
Total cost.....	101,323	58,404
Accumulated depreciation.....	(29,974)	(24,267)
Property, plant and equipment, net.....	\$ 71,349	\$ 34,137

## INTANGIBLE ASSETS (IN THOUSANDS):

	AT DECEMBER 31,	
	1996	1995
Goodwill.....	\$ 16,991	\$ 17,854
Capitalized software.....	6,370	6,370
Distribution and product rights.....	1,475	1,800
Patents.....	4,860	1,750
Other.....	--	1,400
Total cost.....	29,696	29,174
Accumulated amortization.....	(7,368)	(8,944)
Intangible assets, net.....	\$ 22,328	\$ 20,230

## NOTE 4: STATEMENT OF CASH FLOWS DATA

Supplemental disclosure of cash flow information (in thousands):

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Income taxes paid.....	\$1,418	\$3,076	\$971
Interest paid.....	1,172	197	101

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

## NOTE 5: NOTES PAYABLE

## LINE OF CREDIT AGREEMENT

The Company may borrow up to \$75 million under the terms of an unsecured revolving credit agreement which expires May 31, 1997. Interest rates depend on the form of borrowing and vary based on published rates. As of December 31, 1996, the weighted average interest rate was approximately 6.8%. A commitment fee is required on the unused portion of available credit. The agreement contains covenants that require the Company to maintain certain minimum liquidity, liability and tangible net worth measures.

## LONG-TERM NOTES PAYABLE

Long-term debt consists of the following (in thousands):

	AT DECEMBER 31,	
	1996	1995
Secured note payable to a shareholder with interest only payments of 7 1/2% until August 1, 1998 and then principal and interest payments of 9% until maturity on August 1, 2015.....	\$5,600	\$5,600
Secured note payable to a shareholder with interest only payments of 7 1/2% until June 1, 1999 and then principal and interest payments equal to 8 1/2% until maturity on June 1, 2019.....	840	--
Total long-term notes payable.....	\$6,440	\$5,600

The Company incurred the above notes in conjunction with the purchase of the Company's headquarters and additional manufacturing space in Spokane, Washington. Principal payments due under these notes are \$12,000 in 1998, \$48,000 in 1999, \$61,000 in 2000, \$66,000 in 2001 and \$6.3 million thereafter. There are no principal payments due under these notes in 1997.

## NOTE 6: ACQUISITIONS

## UTILITY TRANSLATION SYSTEMS (UTS)

On March 25, 1996, the Company merged with UTS, a provider of software and support services that translates, communicates and analyzes energy consumption data. The Company issued 971,427 shares of its unregistered Common Stock to the shareholders of UTS in exchange for all of the UTS outstanding shares. The merger has been accounted for as a pooling of interests and is treated as a tax-free exchange. Under the pooling-of-interests method of accounting, all prior periods have been restated to include the financial position and results of operations of UTS.

The following summarizes the effects of the merger on amounts previously reported by the Company prior to the transaction for the periods presented.

	COMPANY	UTS	COMBINED
Quarter Ended March 31, 1996			
Revenues.....	\$ 46,575	\$1,477	\$ 48,052
Net income.....	2,712	316	3,028
Year Ended December 31, 1995			
Revenues.....	\$155,350	\$5,985	\$161,335
Net income.....	10,087	1,064	11,151
Year Ended December 31, 1994			
Revenues.....	\$120,659	\$5,255	\$125,914
Net income.....	7,961	2,302	10,263

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

## METSCAN

In September 1995, the Company purchased the net assets of Metscan, Inc., a manufacturer of telephone-based data collection technology. Of the \$4.6 million purchase price, \$3.8 million was paid in cash at closing, with a \$735,000 holdback pending settlement of potential warranty or other claims as of December 31, 1995. As of December 31, 1996 the Company had allocated the entire amount of the holdback against such warranties and claims. Approximately \$2.3 million of the purchase price was allocated to tangible assets and the remaining \$2.3 million to intangible assets which are being amortized over five years. The acquisition was accounted for as a purchase.

## NOTE 7: COMMITMENTS

The Company has noncancelable operating leases for office, production and storage space expiring at various dates through June 2008. Future minimum payments required under operating leases at December 31, 1996 are \$1.9 million in 1997, \$1.4 million in 1998, \$1.3 million in 1999, \$1.2 million in 2000, \$569,000 in 2001 and \$2.2 million thereafter.

Total rent expense under noncancelable operating leases is as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Year Ended December 31,			
Related parties.....	\$ 7	\$ 430	\$ 789
Unrelated parties.....	1,505	1,396	1,296
Total.....	\$1,512	\$1,826	\$2,085
	=====	=====	=====

In order to maintain certain distribution rights, the Company has agreed to purchase minimum quantities of components from various suppliers. Minimum purchase requirements under these agreements are approximately \$5.0 million in 1997, \$6.9 million in 1998, \$5.2 million in 1999, \$2.3 million in 2000 and \$2.7 million in 2001. These commitments are not in excess of anticipated requirements.

## NOTE 8: SHAREHOLDERS' EQUITY

## WARRANTS

At December 31, 1996 and 1995, the Company had outstanding warrants to purchase 375,000 shares of common stock at \$11.63 per share. The warrants were granted at various dates beginning September 1990 through June 1992 at prices no less than fair market value on the date of grant and expire in June 1997 through June 2000.

## OTHER SHAREHOLDERS' EQUITY

Other shareholders' equity is as follows (in thousands):

	AT DECEMBER 31,	
	1996	1995
Unrealized gain on short-term investments.....	\$ --	\$ 158
Foreign currency translation adjustment.....	(107)	(300)
Other shareholders' equity.....	\$(107)	\$(142)
	=====	=====

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

## NOTE 9: STOCK-BASED COMPENSATION PLANS

At December 31, 1996, the Company had two option plans, which are described below. The Company applies APB Opinion 25 and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its fixed stock options plans.

The following table summarizes information about stock options outstanding at December 31, 1996 (options in thousands):

RANGE OF EXERCISE PRICES	NUMBER OF OPTIONS OUTSTANDING AT 12/31/96	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF OPTIONS EXERCISABLE AT 12/31/96	WEIGHTED AVERAGE EXERCISE PRICE
\$ 2.91.....	41	2	\$ 2.91	41	\$ 2.91
2.91 - 6.20.....	36	3	5.97	36	5.97
7.75.....	39	4	7.75	39	7.75
7.75 - 13.00.....	33	5	11.24	33	11.24
13.00 - 13.50.....	182	6	13.02	182	13.02
17.00 - 21.25.....	169	7	17.86	107	17.85
20.63 - 27.00.....	263	8	25.40	118	25.06
51.19 - 58.75.....	19	9	55.95	12	58.75
15.63 - 17.75.....	570	10	17.71	0	0
	-----			---	
Total.....	1,352	8	\$17.92	568	\$15.75
	=====			===	

## 1989 RESTATED STOCK OPTION PLAN

Under the Company's 1989 Restated Stock Option Plan, options to purchase shares of common stock have been granted to directors and employees at prices no less than the fair market value on the date of grant. Options outstanding under the plan become fully exercisable within three or four years from the date granted and terminate ten years from the date granted. Qualified and nonqualified options are exercisable at prices ranging from \$2.91 to \$51.19 per share. The price ranges of options exercised were \$2.91 to \$24.50 in 1996, \$2.91 to \$17.88 in 1995 and \$1.12 to \$13.50 in 1994. At December 31, 1996, there were 1,435,222 shares of unissued common stock reserved for issuance under the plan, of which options for the purchase of 167,785 shares were available for future grants. Numbers of shares under the plan are as follows (shares in thousands):

	YEAR ENDED DECEMBER 31,					
	1996		1995		1994	
	SHARES	WGTD. AVG. EXERCISE PRICE	SHARES	WGTD. AVG. EXERCISE PRICE	SHARES	WGTD. AVG. EXERCISE PRICE
Beginning balance.....	1,038	\$17.36	864	\$11.52	1,055	\$ 7.55
Granted.....	1,016	31.34	412	25.47	215	17.90
Exercised.....	(152)	11.56	(159)	8.50	(387)	4.11
Canceled.....	(635)	41.38	(79)	13.64	(19)	14.33
	-----		-----		-----	
Ending balance.....	1,267	17.24	1,038	17.36	864	11.52
	=====		=====		=====	
Options exercisable.....	483		411		421	

## 1992 STOCK OPTION PLAN FOR NONEMPLOYEE DIRECTORS

The Company's 1992 Stock Option Plan for Nonemployee Directors provides for the annual grant of nonqualified options to purchase 2,000 shares of common stock to nonemployee directors of the Company at an

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

exercise price that is not less than the fair market value per share at the date of grant. Outstanding options granted under the plan are exercisable at prices ranging from \$13.50 to \$58.75 per share. The options granted are fully vested and immediately exercisable. At December 31, 1996, there were 153,000 shares of unissued common stock reserved for issuance under the plan, of which options for the purchase of 68,000 shares were available for future grant. Numbers of shares under the plan are as follows:

	YEAR ENDED DECEMBER 31,					
	1996		1995		1994	
	SHARES	WGTD. AVG. EXERCISE PRICE	SHARES	WGTD. AVG. EXERCISE PRICE	SHARES	WGTD. AVG. EXERCISE PRICE
Beginning balance.....	87	\$22.92	19	\$16.47	6	\$13.50
Granted.....	12	58.75	70	24.50	14	17.54
Exercised.....	(14)	21.96	(2)	17.00	(1)	13.50
	---		---		---	
Ending balance.....	85	28.14	87	22.92	19	16.47
	===		===		===	
Options exercisable.....	85		87		19	

Had compensation costs for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method prescribed in Statement of Financial Accounting Standards No. 123, the Company's net income and earnings per share would have been reduced to the proforma amounts indicated below (in thousands except per share data):

	AT DECEMBER 31,	
	1996	1995
Net Income (loss)		
As Reported.....	\$ (1,464)	\$11,151
Proforma.....	(7,763)	8,232
Earnings Per Share		
As Reported.....	\$ (.11)	\$ .81
Proforma.....	(.58)	.60

The weighted average fair value of options granted during the year was \$18.64. The fair value of each option granted during 1995 and 1996 is estimated on the date of grant using the Black-Scholes option-pricing model using the following assumptions:

	1996	1995
Dividend yield.....	0%	0%
Expected volatility.....	55%	44%
Risk-free interest rate.....	6.2%	6.4%
Expected life (years).....	6.0	4.8

## EMPLOYEE STOCK PURCHASE PLAN

Under the Company's Employee Stock Purchase Plan, the Company is authorized to issue up to 80,000 shares of common stock to its eligible employees who have completed three months of service, work more than 20 hours each week and are employed more than five months in any calendar year. Employees who own 5% or more of the Company's Common Stock are not eligible to participate in the plan. Under the terms of the plan, eligible employees can choose payroll deductions each year of up to 10% of their regular cash compensation. Such deductions are applied toward the discounted purchase price of the Company's Common Stock. The purchase price of the Common Stock is 85% of the fair market value of the stock as defined in the plan. Approximately 25% of eligible employees have participated in the plan since its inception on July 1, 1996. Under the plan, the Company sold 8,331 shares to employees in 1996.

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

## NOTE 10: EMPLOYEE BENEFITS

The Company has an employee incentive savings plan in which substantially all employees are eligible to participate. Employees may contribute on a tax-deferred basis up to 15% of their salary, 50% of which, subject to certain limitations, is matched by the Company by issuance of common stock. Prior to 1996, the Company matched 25% of employee contributions with issuance of common stock. The expense for the Company's matching contribution was \$798,000 in 1996, \$310,000 in 1995 and \$221,000 in 1994. The Company does not offer postemployment or postretirement benefits.

## NOTE 11: INCOME TAXES

A reconciliation of income taxes at the expected tax rate of 35% to the consolidated effective tax for continuing operations is as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Expected federal income tax.....	\$ (747)	\$ 5,740	\$ 4,968
State income taxes.....	(19)	533	505
Goodwill amortization.....	309	349	341
Exempt interest.....	(152)	(593)	(187)
Tax credits.....	(762)	(433)	(544)
Foreign operations.....	59	(234)	(497)
UTS acquisition.....	376	(372)	(925)
Meals and entertainment.....	243	132	100
Other, net.....	23	128	169
Provision (benefit) for income taxes.....	\$ (670)	\$ 5,250	\$ 3,930

The domestic and foreign components of income from continuing operations before taxes were (in thousands):

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Domestic.....	\$ 1,525	\$15,507	\$12,142
Foreign.....	(3,659)	894	2,051
Income (loss) before income taxes.....	\$ (2,134)	\$16,401	\$14,193

The provision for income taxes consists of the following (in thousands):

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Current			
Federal.....	\$ 678	\$ 4,104	\$ 3,040
State and local.....	197	388	10
Total current.....	875	4,492	3,050
Deferred			
Federal.....	(844)	1,033	909
State and local.....	130	(275)	(29)
Foreign.....	(831)	--	--
Total deferred.....	(1,545)	758	880
Total provision (benefit) for income taxes.....	\$ (670)	\$ 5,250	\$ 3,930

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The components of the provision (benefit) for deferred income taxes are (in thousands):

	AT DECEMBER 31,		
	1996	1995	1994
Tax credits and loss carryforwards.....	\$ (1,440)	\$370	\$ (707)
Accrued expenses.....	(865)	(442)	(116)
Acquisitions.....	375	--	--
Depreciation and amortization.....	981	(289)	1,038
Inventory.....	(1,270)	(257)	671
Long-term contracts.....	712	1,384	--
Other, net.....	(38)	(8)	(6)
	-----	-----	-----
Total deferred income taxes.....	\$ (1,545)	\$758	\$ 880
	=====	=====	=====

At December 31, 1996, deferred income taxes consisted of the following (in thousands):

## CURRENT:

-----	
Tax credits and loss	
carryforwards.....	\$ 12
Accrued expenses.....	2,283
Acquisitions.....	(74)
Inventory.....	1,957
Long-term contracts.....	(119)
Other, net.....	112
	-----
Total current.....	\$4,171
	=====

## NONCURRENT:

-----	
Tax credits and loss	
carryforwards.....	\$4,597
Accrued expenses.....	884
Acquisitions.....	(301)
Depreciation and	
amortization.....	(2,973)
Long-term contracts.....	(1,977)
	-----
Total noncurrent.....	\$ 230
	=====

Valuation allowances of \$129,000 and \$802,000 in 1996, and \$35,000 and \$379,000 in 1995 were provided for capital loss carryforwards and foreign net operating loss carryforwards, respectively, for which the Company may not receive future benefits.

The Company has research and development tax credits available to offset future income tax liabilities. The tax credits expire through 2011 as follows (in thousands):

YEAR	AMOUNT
-----	-----
2003-2005.....	\$ 54
2006-2008.....	1,632
2009-2011.....	1,541

The Company also has alternative minimum tax credits, totaling \$324,000, that are available to offset future tax liabilities.

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

## NOTE 12: SEGMENT INFORMATION

Summarized information regarding the Company's domestic and international operations is as follows (in thousands):

	DOMESTIC	INTERNATIONAL	CONSOLIDATED OPERATIONS
	-----	-----	-----
Year ended December 31, 1996:			
Revenue.....	\$162,494	\$15,090	\$177,584
Income (loss) from continuing operations before taxes.....	6,009	(8,143)	(2,134)
Identifiable assets.....	175,824	11,597	187,421
Year ended December 31, 1995:			
Revenue.....	\$134,111	\$27,224	\$161,335
Income (loss) from continuing operations before taxes.....	18,020	(1,619)	16,401
Identifiable assets.....	139,223	10,495	149,718
Year ended December 31, 1994:			
Revenue.....	\$109,018	\$16,896	\$125,914
Income (loss) from continuing operations before taxes.....	16,490	(2,297)	14,193
Identifiable assets.....	115,791	6,542	122,333

Domestic information includes the United States and Canada. Approximately 22% of 1996 and 14% of 1995 consolidated revenues relate to a contract with a significant customer. International information includes wholly owned subsidiaries located in the United Kingdom, France and Australia, as well as sales to international distributors, which were \$5.9 million in 1996, \$15.7 million in 1995 and \$3.3 million in 1994. International revenues include sales to customers located in Europe, Australia, Japan, Latin America and the Middle East.

## NOTE 13: OTHER RELATED PARTY TRANSACTIONS

Certain of the Company's customers are also shareholders with more than 10% ownership interest and/or hold positions on the Company's Board of Directors. Revenue from such customers was \$4.3 million in 1996, \$2.1 million in 1995 and \$3.2 million in 1994. Accounts receivable from these customers were \$541,000 and \$1.2 million at December 31, 1996 and 1995, respectively. Interest expense related to a note payable to a shareholder was \$456,000 in 1996 and \$157,000 in 1995.

## NOTE 14: DEVELOPMENT AGREEMENTS

The Company receives funding to develop certain products under joint development agreements with several companies. Intellectual property rights to such developed products remain with the Company. Funding received under these agreements is netted against product development expenses. The agreements provide for royalty payments by the Company if successful products are developed and sold. Additionally, the Company is required to pay royalties on future sales of products incorporating certain AMR technologies.

Funding received and royalty expense under these arrangements is as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	-----	-----	-----
	1996	1995	1994
	-----	-----	-----
Funding received.....	\$ 143	\$ 657	\$1,100
Royalties paid.....	1,614	1,889	1,774

## ITRON, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

## NOTE 15: QUARTERLY RESULTS (UNAUDITED)

Quarterly results are as follows (in thousands, except per share data):

1996 ----	FOURTH QUARTER -----	THIRD QUARTER (2) -----	SECOND QUARTER -----	FIRST QUARTER -----
Statement of operations data:				
Total revenues.....	\$42,594	\$ 38,743	\$48,195	\$48,052
Gross profit.....	15,814	14,566	20,994	21,502
Net income (loss).....	(2,301)	(4,546)	2,355	3,028
Net income (loss) per share.....	(.17)	(.34)	.17	.21
Pro forma information:(1)				
Net income (loss).....				\$ 2,918
Net income (loss) per share.....				.21

1995  
----

Statement of operations data:				
Total revenues.....	\$44,139	\$39,931	\$39,144	\$38,121
Gross profit.....	20,084	17,958	16,892	16,805
Net income.....	2,918	2,145	2,825	3,263
Net income per share.....	.21	.16	.20	.24
Pro forma information:(1)				
Net income.....	\$ 2,818	\$ 2,295	\$ 2,735	\$ 2,913
Net income per share.....	.20	.17	.20	.21

(1) Prior to merging with the Company, UTS was treated as an S corporation under the Internal Revenue Code of 1986, as amended. The income of an S corporation is taxed directly to the shareholders and no federal or state income taxes are paid by the company. Consequently, the combined results of operations for the first quarter of 1996 and the full year 1995 exclude an income tax provision on UTS' earnings. Pro forma information reflects a provision for income taxes as if UTS was taxed as a C corporation using the Company's effective tax rate.

(2) In the third quarter of 1996, the Company incurred \$2.9 million in one-time charges for the redesign of certain products and severance charges related to a reduction in workforce.

Board of Directors and Shareholders of Itron, Inc.  
Spokane, Washington

We have audited the financial statements of Itron, Inc. as of December 31, 1996 and 1995, and for each of the three years in the period ended December 31, 1996, and have issued our report thereon dated February 7, 1997; such financial statements and report are included herein. Our audit also included the financial statement schedule of Itron, Inc. listed in Item 14. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

Deloitte & Touche LLP

Seattle, Washington  
February 7, 1997

ITRON, INC.  
 SCHEDULE II:  
 VALUATION AND QUALIFYING ACCOUNTS  
 (THOUSANDS OF DOLLARS)

Description	Additions			Balance at end of period		
	Balance at beginning of period	Charged to costs and expenses	Charged to other accounts (1)	Deductions	Current	Non current
YEAR ENDED DECEMBER 31, 1994:						
Inventory obsolescence	2,954	1,459		3,048	1,365	
Warranty	2,572	1,044		1,289	555	1,772
Allowance for doubtful accounts	256	611		565	302	
YEAR ENDED DECEMBER 31, 1995:						
Inventory obsolescence	1,365	2,121		1,623	1,863	
Warranty	2,327	1,452		794	882	2,103
Allowance for doubtful accounts	302	327	78	198	509	
YEAR ENDED DECEMBER 31, 1996:						
Inventory obsolescence	1,863	5,722		3,454	4,131	
Warranty	2,985	2,664		2,280	1,212	2,157
Allowance for doubtful accounts	509	550		307	752	

(1) Additions charged to other accounts consist of reserves of acquired businesses.

ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10: DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The section entitled "Election of Directors" appearing in the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on April 29, 1997 (the "1997 Proxy Statement") sets forth certain information with regard to the directors of the Registrant and is incorporated herein by reference. Certain information with respect to persons who are or may be deemed to be executive officers of the Registrant is set forth under the caption "Executive Officers of the Registrant" in Part I of this Annual Report on Form 10-K.

ITEM 11: EXECUTIVE COMPENSATION

The section entitled "Executive Compensation" appearing in the 1997 Proxy Statement sets forth certain information (except for those sections captioned "Compensation Committee Report on Executive Compensation" and "Performance Graph", which are not incorporated by reference herein) with respect to the compensation of management of the Registrant and is incorporated herein by reference.

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The section entitled "Security Ownership of Certain Beneficial Owners and Management" appearing in the 1997 Proxy Statement sets forth certain information with respect to the ownership of the Registrant's Common Stock and is incorporated herein by reference.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The section entitled "Certain Relationships and Related Transactions" appearing in the 1997 Proxy Statement sets forth certain information with respect to the certain business relationships and transactions between the Registrant and its directors and officers and is incorporated herein by reference.

ITEM 14: EXHIBITS, FINANCIAL STATEMENTS SCHEDULES AND REPORTS ON  
FORM 8-K

2) LIST OF CONSOLIDATED FINANCIAL STATEMENT SCHEDULES:

The consolidated financial statement schedules listed below of Itron, Inc. as of and for the years ended December 31, 1996, 1995 and 1994 are included in this Form 10-K.

Independent Auditors' Reports

Schedule II - Valuation and Qualifying Accounts

All other schedules have been omitted because they are not required, not applicable, or the required information is included in the consolidated financial statements or the notes thereto.

## 3) EXHIBITS:

Exhibit Number	Description of Exhibits
3.1	Restated Articles of Incorporation of the Registrant. (A) (Exhibit 3.1)
3.2	Restated Bylaws of the Registrant. (A) (Exhibit 3.2)
4.1	Rights Agreement between the Registrant and Chemical Trust Company of California dated as of July 15, 1992. (A) (Exhibit 4.1)
10.1	Form of Change of Control Agreement between Registrant and certain of its executive officers, together with schedule executive officers who are parties thereto.* (D) (Exhibit 10.1)
10.2	Employment Agreement between the Registrant and Johnny M. Humphreys dated February 9, 1987, First Addendum dated November 22, 1988 and Second Addendum dated July 21, 1992 (A).* (Exhibit 10.2)
10.3	Form of Confidentiality Agreement normally entered into with employees. (A) (Exhibit 10.7)
10.4	Amended and Restated Registration Rights Agreement among the Registrant and certain holders of its securities dated March 25, 1996.
10.5	1989 Restated Stock Option Plan. (C) (Exhibit 10.7) *
10.6	1992 Restated Stock Option Plan for Nonemployee Directors. (C) (Exhibit 10.8) *
10.7	Executive Deferred Compensation Plan. (A) * (Exhibit 10.12)
10.8	Form of Class A Warrant Certificates for shares of Common Stock of the Registrant dated from July 10, 1989 to March 5, 1992, together with schedule of holders. (C) (Exhibit 10.12)

- 10.9 Form of Class AA Warrant Certificates for shares of Common Stock of the Registrant dated June 30, 1992, together with schedule of holders. (C) (Exhibit 10.13)
- 10.10 Form of Indemnification Agreements between the Registrant and certain directors and officers. (D) (Exhibit 10.14)
- 10.11 Schedule of directors and officers who are parties to Indemnification Agreements (see Exhibit 10.10 hereto) with the Registrant.
- 10.12 Employment Agreement between the Registrant and Carl Robert Aron dated November 22, 1995. \* (D) (Exhibit 10.15)
- 10.13 Employment Agreement between the Registrant and David G. Remington dated February 29, 1996. \* (D) (Exhibit 10.16)
- 10.14 Office Lease between the Registrant and Woodville Leasing Inc. dated October 4, 1993. (B) (Exhibit 10.24).
- 10.15 Contract between the Registrant and Duquesne Light Company dated January 15, 1996. (DELTA) (D) (Exhibit 10.18)
- 10.16 Purchase Agreement between the Registrant and Pentzer Development Corporation dated July 11, 1995. (D) (Exhibit 10.19)
- 10.17 Loan Agreement between Itron, Inc. and Washington Trust Bank dated July 1, 1996, as amended January 15, 1997.
- 11 Computation of Earnings per Share.
- 21.1 Subsidiaries of the registrant
- 27.1 Financial Data Schedule
- (A) Incorporated by reference to designated exhibit included in the Company's Registration Statement on Form S-1 (Registration #33-49832), as amended, filed on July 22, 1992.
- (B) Incorporated by reference to designated exhibit included in the Company's 1993 Annual Report on Form 10-K filed on March 30, 1994.
- (C) Incorporated by reference to designated exhibit included in the Company's 1994 Annual Report on Form 10-K filed on March 30, 1995.
- (D) Incorporated by reference to designated exhibit included in the Company's 1995 Annual Report on Form 10-K filed on March 30, 1996.
- \* Management contract or compensatory plan or arrangement.
- (DELTA) Confidential treatment requested for a portion of this agreement.

4) REPORTS ON FORM 8-K:

A current report on Form 8-K, dated October 3, 1996, was filed during the fourth quarter of 1996 to report the filing by the Company of a patent infringement action in the District Court for the District of Minnesota. See "Legal Proceedings."

## SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) 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, in the City of Spokane, State of Washington, on the 26th day of February, 1997.

ITRON, INC.

By /s/ DAVID G. REMINGTON

-----  
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities indicated below on the 26th day of February, 1997.

Signature -----	Title -----
/s/ PAUL A. REDMOND ----- Paul A. Redmond	Chairman of the Board
/s/ JOHNNY M. HUMPHREYS ----- Johnny M. Humphreys	President, Chief Executive Officer and Director (Principal Executive Officer)
/s/ DAVID G. REMINGTON ----- David G. Remington	Chief Financial Officer (Principal Financial and Accounting Officer)
/s/ MICHAEL B. BRACY ----- Michael B. Bracy	Director
/s/ TED C. DEMERRITT ----- Ted C. DeMerritt	Director
/s/ JON E. ELIASSEN ----- Jon E. Eliassen	Director
/s/ MARY ANN PETERS ----- Mary Ann Peters	Director
/s/ W. HUNTER SIMPSON ----- W. Hunter Simpson	Director

/s/ GRAHAM M. WILSON  
-----  
Graham M. Wilson Director

/s/ STUART E. WHITE  
-----  
Stuart E. White Director

## Exhibit Index

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10.8	Form of Class A Warrant Certificates for shares of Common Stock of the Registrant dated from July 10, 1989 to March 5, 1992, together with schedule of holders. (C) (Exhibit 10.12)	

- 10.9 Form of Class AA Warrant Certificates for shares of Common Stock of the Registrant dated June 30, 1992, together with schedule of holders. (C) (Exhibit 10.13)
- 10.10 Form of Indemnification Agreement between the Registrant and certain directors and officers. (D) (Exhibit 10.14)
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- (C) Incorporated by reference to designated exhibit included in the Company's 1994 Annual Report on Form 10-K filed on March 30, 1995.
- (D) Incorporated by reference to designated exhibit included in the Company's 1995 Annual Report on Form 10-K filed on March 30, 1996.
- \* Management contract or compensatory plan or arrangement.
- (DELTA) Confidential treatment requested for a portion of this agreement.

## AMENDED AND RESTATED REGISTRATION RIGHTS AGREEMENT

This AMENDED AND RESTATED REGISTRATION RIGHTS AGREEMENT (this "Agreement") is entered into as of March 25, 1996, among Itron, Inc., a Washington corporation (the "Company"), and the Holders (as defined below).

## RECITALS

A. On February 28, 1992, the Company and certain of the Holders entered into a Registration Rights Agreement consolidating into one agreement various registration rights held by such Holders and extending certain registration rights to NorAm Energy Corp. (formerly Arkla, Inc.) ("NorAm").

B. The Company is now entering into an Agreement and Plan of Merger, dated as of the date hereof (the "UTS Merger Agreement"), with UTS Acquisition Corporation and Utility Translation Systems, Inc. ("UTS"), pursuant to which the Company will issue to Stuart Edward White, David Courtney Godwin and John A. Smith, Jr. an aggregate of 971,427 shares of Common Stock, of which up to 194,286 shares will have certain registration rights as set forth in this Agreement.

C. The parties to this Agreement desire to consolidate into one document their previous agreements, to delete references to persons whose registration rights have been eliminated through sales of the Company's Common Stock and to extend certain registration rights to the recipients of Common Stock pursuant to the UTS Merger Agreement as set forth herein.

D. The parties to this Agreement hereby agree that this Agreement will become effective on and be dated as of the date of the closing of the transactions contemplated by the UTS Merger Agreement and will be of no force and effect should such transactions not be consummated.

## AGREEMENT

Now, therefore, for good and valuable consideration, the adequacy and receipt of which is acknowledged, the parties hereto agree as follows:

## SECTION 1. CERTAIN DEFINITIONS

As used in this Agreement, the following terms shall have the following respective meanings:

(a) "Commission" shall mean the United States Securities and Exchange Commission or any other United States federal agency at the time administering the Securities Act.

(b) "Form S-3" shall mean Form S-3 issued by the Commission or any substantially similar form then in effect.

(c) "Holder" shall mean any of the parties listed on Schedule A hereto that hold outstanding Registrable Securities which have not been sold to the public, or an assignee or transferee of registration rights from such parties as permitted by Section 9.

(d) "Initiating Holders" shall have the meaning set forth in subsection 2.1.1 except that when used in subsections 2.2, 2.4 and 2.5 with respect to a Registration requested by Centra pursuant to subsection 2.1.2, it shall mean Centra, when used in subsections 2.2, 2.4 and 2.5 with respect to a Registration requested by NorAm pursuant to subsection 2.1.3, it shall mean NorAm, and when used in subsections 2.4 and 2.5 with respect to a Registration requested by the UTS Holders pursuant to subsection 2.1.4, it shall mean the UTS Holders.

(e) "Register," "Registered" and "Registration" refer to a registration effected by preparing and filing a registration statement in compliance with the Securities Act (the "Registration Statement"), and the declaration or ordering of the effectiveness of such Registration Statement.

(f) "Registrable Securities" shall mean (i) all the Common Stock of the Company issued upon conversion of any shares of the Company's Series A Preferred Stock and Series B Preferred Stock; (ii) all the Common Stock of the Company issued or issuable upon the exercise of that certain warrant, dated June 15, 1988, issued pursuant to the Securities Purchase Agreement dated June 15, 1988 with Inter-City Gas Corporation ("ICG"), as at any time amended, by the Company to CHL Holdings, Inc., a subsidiary of ICG, and reissued on June 29, 1990 to ICG Utilities (Canada) Ltd. and on January 21, 1991 to Centra Gas Inc., successors in interest to ICG ("Centra"), as at any time amended; (iii) all the Common Stock of the Company issued or issuable upon the exercise of warrants to purchase shares of the Company's Common Stock acquired from AMRplus Partners, a Research and Development Limited Partnership (the "AMR Warrants"); (iv) all the Common Stock of the Company issued to NorAm pursuant to the terms of the NorAm Merger Agreement; (v) the UTS Registrable Securities; and (vi) all the Common Stock of the Company issued with respect to such shares by reason of stock dividends, stock splits, or combinations, recapitalizations or other similar corporate action.

(g) "Registration Expenses" shall mean all expenses incurred by the Company in complying with Section 2 or Section 3, including, without limitation, all federal and state registration, qualification, and filing fees, printing expenses, fees and disbursements

of counsel for the Company, blue sky fees and expenses, and the expense of any special audits incident to or required by any such registration.

(h) "Securities Act" shall mean the Securities Act of 1933, as amended, or any similar federal statute and the rules and regulations of the Commission thereunder, all as the same shall be in effect at the time.

(i) "Selling Expenses" shall mean all underwriting discounts and selling commissions applicable to the sale of Registrable Securities pursuant to this Agreement.

(j) "UTS Holder" is defined as any of Stuart Edward White, David Courtney Godwin and John A. Smith, Jr.

(k) "UTS Registrable Securities" shall mean (i) the 194,286 shares of Common Stock received by the UTS Holders pursuant to the UTS Merger Agreement that are granted registration rights pursuant to this Agreement and (ii) all the Common Stock of the Company issued with respect to such shares by reason of stock dividends, stock splits, or combinations, recapitalizations or other similar corporate action; provided, however, in any Registration, the UTS Holders as a group shall be entitled only to sell that number of UTS Registrable Securities equal to the maximum number of shares eligible to be sold pursuant to the Registration, and, absent an agreement among the UTS Holders to the contrary, each UTS Holder shall be entitled only to sell that number of UTS Registrable Securities equal to such maximum number multiplied by a fraction equal to the UTS Registrable Securities held by such UTS Holder divided by the number of UTS Registrable Securities held by all UTS Holders at the time of the filing of such Registration.

## SECTION 2. DEMAND REGISTRATION

### 2.1 REQUEST FOR REGISTRATION ON FORMS OTHER THAN FORM S-3

#### 2.1.1 GENERAL

Subject to the remainder of this Agreement, in the event that the Company shall receive from Holders of Registrable Securities (the "Initiating Holders") a written request that the Company effect any Registration with respect to all or a part of the Registrable Securities on a form other than Form S-3 for an offering of at least 20% of the then outstanding Registrable Securities having a reasonably anticipated aggregate offering price to the public equal to or greater than \$3,000,000 (U.S.), the Company shall (i) promptly give written notice of the proposed Registration to all other Holders and shall (ii) as soon as practicable, use its diligent best efforts to effect the prompt Registration of the Registrable Securities specified in such request, together with any Registrable Securities of any Holder joining in such request as are specified in a written request given within 20 days after delivery of written notice from the Company. The Company shall not be obligated to take any action to effect any such registration pursuant to this subsection 2.1.1 within six months after the

effective date of a Registration initiated by the Company or, except as provided in subsection 2.1.2, after the Company has effected two such Registrations pursuant to this subsection 2.1.1 and such Registrations shall have been declared effective (the "Demand Registrations").

#### 2.1.2 CENTRA DEMAND REGISTRATION

If (a) the Company has effected the Demand Registrations pursuant to subsection 2.1.1 and (b) Centra's participation in the Demand Registrations did not result in a reduction in the number of shares of Registrable Securities that the other Holders of Registrable Securities desired and were allowed to register in the Demand Registrations, then Centra may notify the Company in writing that it requests a Registration pursuant to this subsection 2.1.2; provided, however, that in such Registration Centra must register Registrable Securities owned by it having a reasonably anticipated aggregate offering price to the public equal to or greater than \$15,000,000 (U.S.), or, with respect to a Registration in which Centra is registering all its Registrable Securities, \$5,000,000 (U.S.). Other Holders of Registrable Securities shall have the right to participate in the Centra Registration hereunder only to the extent that such participation does not preclude Centra from registering in such Registration the total number of Registrable Securities Centra requests in such notification. After receiving Centra's notice, the Company shall (i) promptly give written notice of the proposed Registration to all other Holders stating the terms upon which such Holders can participate in such Registration and (ii) as soon as practicable, use its diligent best efforts to effect the prompt Registration of the Registrable Securities specified in Centra's request, together with any Registrable Securities (subject to the limitations of this subsection 2.1.2) of any Holder joining in such request that are specified in a written request given within 20 days after delivery of written notice from the Company. The Company shall not be obligated pursuant to this subsection 2.1.2 to (a) take any action to effect any Registration within six months after the effective date of a Registration initiated by the Company or (b) effect more than one Registration.

#### 2.1.3 NORAM DEMAND REGISTRATIONS

Any time during the period commencing six months after the effective date of the Company's initial Registration and ending three years after such effective date, NorAm may notify the Company in writing that it requests a Registration pursuant to this subsection 2.1.3 to Register for sale all of the Registrable Securities owned by it. Other Holders of Registrable Securities shall have the right to participate in the NorAm Registration hereunder only to the extent that such participation does not preclude NorAm from registering in such Registration the total number of Registrable Securities it requests in such notification. After receiving NorAm's notice, the Company shall (i) promptly give written notice of the proposed Registration to all other Holders stating the terms upon which such Holders can participate in such Registration and (ii) as soon as practicable, use its diligent best efforts to effect the prompt Registration of the Registrable Securities specified in NorAm's request, together with any Registrable Securities (subject to the limitations of this subsection 2.1.3) of

any Holder joining in such request that are specified in a written request given within 20 days after delivery of written notice from the Company. The Company shall not be obligated pursuant to this subsection 2.1.3 to effect more than one Registration for NorAm unless NorAm is unable in such Registration to sell all its Registrable Securities because of the advice of the Underwriter's Representative (as defined in subsection 2.5.2) requiring a limitation of the number of shares of Registrable Securities to be sold by NorAm. In such event, NorAm shall be entitled to two additional Registrations to be effected according to the terms of this subsection 2.1.3, exercisable at least nine months apart, and for the Registration of Registrable Securities owned by NorAm having a reasonably anticipated aggregate offering price to the public equal to or greater than \$5,000,000 (U.S.) or such lesser amount equal to the number of shares of Registrable Securities as NorAm shall then own which cannot be sold by NorAm in a transaction pursuant to Rule 144.

#### 2.1.4 UTS DEMAND REGISTRATION

In the event that prior to the expiration of one year from the date of this Agreement the Company does not effect a Registration triggering the rights of the UTS Holders set forth in subsection 3.1.2, or in the event that the Company effects such a Registration or Registrations and the UTS Holders request participation and the extent of the UTS Holders' participation is reduced in accordance with the terms of this Agreement to fewer than 97,143 shares of UTS Registrable Securities, the UTS Holders shall be provided with a demand registration right pursuant to this subsection 2.1.4 with respect to 97,143 shares of the UTS Registrable Securities minus any amount previously sold by the UTS Holders in connection with any Registration or Registrations prior to the time the demand right under this subsection 2.1.4 is exercised. In the event that the Company shall receive, at any time between the date one year from date of this Agreement and the date two years from date of this Agreement, a written request from the UTS Holders that the Company effect a Registration with respect to all or a part of the UTS Registrable Securities referenced in the preceding sentence and having a reasonably anticipated aggregate offering price to the public equal to or greater than \$1,500,000 (U.S.), then the Company shall as soon as practicable, use its diligent best efforts to effect the prompt Registration of the UTS Registrable Securities specified in such request. The Company will not be obligated pursuant to this subsection 2.1.4 to (a) take any action to effect any Registration within six months after the effective date of a Registration initiated by the Company or (b) effect more than one Registration. If the Company shall furnish to the UTS Holders a certificate signed by the President of the Company stating that, in the good faith judgment of the Board of Directors of the Company, it would be detrimental to the Company for any Registration requested under this subsection 2.1.4 to occur at the time the request is received, the Company shall have the right, exercisable only once, to defer the filing of a Registration Statement with respect to such offering for a period of not more than 60 days from the delivery of the request by the UTS Holders.

2.2 RIGHT OF DEFERRAL OF REGISTRATION ON FORM OTHER THAN  
FORM S-3

If the Company shall furnish to all Holders who joined in the request a certificate signed by the President of the Company stating that, in the good faith judgment of the Board of Directors of the Company, it would be detrimental to the Company for any Registration requested under subsection 2.1 to occur at the time the request is received, the Company shall have the right, exercisable only once in each 12-month period, to defer the filing of a Registration Statement with respect to such offering for a period of not more than 60 days from delivery of the request of the Initiating Holders.

2.3 REQUEST FOR REGISTRATION ON FORM S-3

Subject to the remainder of this Agreement, in the event that the Company receives from Holders a written request that the Company effect any Registration on Form S-3 at a time when the Company is eligible to register securities on Form S-3 for an offering by selling shareholders of Registrable Securities where the aggregate proposed offering price to the public will be at least \$500,000 (U.S.), the Company will promptly give written notice of the proposed Registration to all the Holders and will as soon as practicable use its diligent best efforts to effect Registration of the Registrable Securities specified in such request, together with all or such portion of the Registrable Securities of any Holder joining in such request as are specified in a written request delivered to the Company within 20 days after written notice from the Company of the proposed Registration. There shall be no limit on the number of occasions on which the Company shall be obligated to effect registration under this subsection 2.3.

2.4 REGISTRATION OF OTHER SECURITIES IN DEMAND  
REGISTRATION

Any Registration Statement filed pursuant to the request of the Initiating Holders under this Section 2 may, subject to the provisions of subsection 2.5 and Section 8, include other securities of the Company which are held by persons who, by virtue of agreements with the Company, are entitled to include their securities in such Registration.

2.5 UNDERWRITING IN DEMAND REGISTRATION

2.5.1 NOTICE OF UNDERWRITING

If the Initiating Holders intend to distribute the Registrable Securities covered by their request by means of an underwriting, they shall so advise the Company as a part of their request made pursuant to this Section 2, and the Company shall include such information in the written notice referred to in subsection 2.1.1, 2.1.2, 2.1.3, 2.1.4 or 2.3. The right of any Holder to Registration pursuant to this Section 2 shall be conditioned upon such Holder's agreement to participate in such underwriting and the inclusion of such Holder's Registrable Securities in the underwriting.

2.5.2 SELECTION OF UNDERWRITER IN DEMAND  
REGISTRATION

The Company shall (together with all holders proposing to distribute their securities through such underwriting) enter into an underwriting agreement with the representative (the "Underwriter's Representative") of the underwriter or underwriters selected for such underwriting jointly by a majority of the Registrable Securities being registered by the Initiating Holders and the Company; provided, however, that in the case of a registration pursuant to subsection 2.1.3 in which NorAm is the Initiating Holder, the underwriter or underwriters shall be selected by NorAm subject to the consent of the Company, which consent shall not be unreasonably withheld.

2.5.3 INCLUSION OF OTHER HOLDERS IN  
DEMAND REGISTRATION

If the officers or directors of the Company holding Common Stock other than Registrable Securities request inclusion in such Registration, or if holders of securities other than Registrable Securities request and are legally entitled to inclusion in such Registration, the Initiating Holders shall, on behalf of all Holders, offer to such officers or directors and such holders of securities other than Registrable Securities that such securities other than Registrable Securities be included in the underwriting and may condition such offer on the acceptance by such persons of the terms of this Section 2.

2.5.4 MARKETING LIMITATION IN DEMAND  
REGISTRATION

In the event the Underwriter's Representative advises the Initiating Holders in writing that market factors require a limitation of the number of shares to be underwritten, the Common Stock (other than Registrable Securities) held by officers or directors of the Company, other than UTS Registrable Securities held by Stuart Edward White, shall be excluded from such Registration to the extent required by such limitation. If a limitation of the number of shares is still required, the Initiating Holders shall so advise all holders of securities which, pursuant to subsection 2.4, would otherwise be underwritten pursuant to this subsection 2.5, and the number of shares of such securities that may be included in the Registration and underwriting shall be allocated among all holders thereof in proportion, as nearly as practicable, to the respective amounts of securities held by such holders at the time of filing the Registration Statement. If a limitation of the number of shares is still required, the Initiating Holders shall so advise all Holders who have requested to have their Registrable Securities included in the Registration, and the number of Registrable Securities that may be included in the Registration shall be allocated among all Holders thereof in proportion, as nearly as practicable, to the respective amounts of Registrable Securities held by such Holders at the time of filing the Registration Statement; provided, however, that in a Registration pursuant to subsection 2.1.2, all Holders except Centra shall be subject to such proportional reduction and the Registrable Securities of Centra shall not be reduced unless

there shall be no other Holders participating in such Registration, in a Registration pursuant to subsection 2.1.3, all Holders except NorAm shall be subject to such proportional reduction and the Registrable Securities of NorAm shall not be reduced unless there shall be no other Holders participating in such Registration, and in a Registration pursuant to subsection 2.1.4, all Holders except the UTS Holders shall be subject to such proportional reduction and the Registrable Securities of the UTS Holders shall not be reduced unless there shall be no other Holders participating in such Registration. No Registrable Securities or other securities excluded from the underwriting by reason of this subsection 2.5.4 shall be included in such Registration Statement.

2.5.5 RIGHT OF WITHDRAWAL IN DEMAND  
REGISTRATION

If any Holder of Registrable Securities, or a holder of other securities entitled (upon request) to be included in such Registration, disapproves of the terms of the underwriting, such person may elect to withdraw therefrom by written notice to the Company, the underwriter, and the Initiating Holders delivered at least one day before the effective date of the Registration Statement. The securities so withdrawn shall also be withdrawn from the Registration Statement.

2.5.6 INCLUSION OF THE COMPANY'S  
SECURITIES IN DEMAND REGISTRATION

If the underwriter has not limited the number of Registrable Securities or other securities to be underwritten, the Company may include securities for its own account in such registration and underwriting if the underwriter so agrees and if the number of Registrable Securities and other securities which would otherwise have been included in such Registration and underwriting will not thereby be limited.

2.6 BLUE SKY IN DEMAND REGISTRATION

In the event of any Registration pursuant to this Section 2, the Company will exercise its best efforts to Register and qualify the securities covered by the Registration Statement under such other securities or "blue sky" laws of such jurisdictions as shall be requested by the Underwriter's Representative and reasonably appropriate for the distribution of such securities; provided, however, that (i) the Company shall not be required to qualify to do business or to file a general consent to service of process in any such states or jurisdictions unless the Company is already subject to service in such jurisdiction and except as may be required by the Securities Act, (ii) the Company shall not be required to Register or qualify the securities covered by the Registration Statement in any jurisdiction which requires, as a condition of such Registration or qualification, escrow of securities of the Company held by founders, officers, directors or employees of the Company, and (iii) notwithstanding anything in this Agreement to the contrary, in the event any jurisdiction in which the securities shall be qualified imposes a nonwaivable requirement that expenses incurred in connection with the

qualification of the securities be borne by selling shareholders, such expenses shall be payable pro rata by the selling shareholders.

## 2.7 EXCLUSION FROM DEMAND REGISTRATION

Notwithstanding any other provision of this Agreement to the contrary, (i) Holders of securities that are Registrable Securities from the exercise of AMR Warrants shall have no demand registration rights with respect to such securities pursuant to this Section 2, but shall be entitled only to piggyback registration rights as provided in Section 3, and such securities shall not be counted as Registrable Securities for purposes of this Section 2, and (ii) except for those demand rights specifically set forth in Section 2.1.4, UTS Holders of UTS Registrable Securities shall have no demand registration rights with respect to such securities pursuant to this Section 2 (including pursuant to subsection 2.1.1 and subsection 2.3).

## SECTION 3. PIGGYBACK REGISTRATION

### 3.1 NOTICE OF PIGGYBACK REGISTRATION AND INCLUSION OF REGISTRABLE SECURITIES

#### 3.1.1 GENERAL PIGGYBACK RIGHTS

Subject to the remainder of this Agreement and subsection 3.1.2 below, in the event the Company decides to Register any of its Common Stock (either for its own account or the account of a security holder or holders exercising their respective demand registration rights) on a form that would be suitable for a registration involving Registrable Securities, the Company will (i) promptly give each Holder written notice thereof (which shall include a list of the jurisdictions in which the Company then intends to attempt to qualify such securities under the applicable "blue sky" or other state securities laws) and (ii) include in such Registration (and any related qualification under state securities or "blue sky" laws or other compliance), and in any underwriting involved therein, all the Registrable Securities specified in a written request delivered to the Company by any Holder within 20 days after delivery of such written notice from the Company.

#### 3.1.2 LIMITATION OF UTS PIGGYBACK RIGHTS

To the extent that the UTS Holders elect to participate in a Registration referenced in subsection 3.1.1, the number of UTS Registrable Securities for which the UTS Holders may request registration is limited by this subsection 3.1.2. If the Registration referenced by subsection 3.1.1 is filed prior to the expiration of one year from the date of this Agreement, the UTS Holders may only request registration of a total of 97,143 shares of the UTS Registrable Securities. If the Registration referenced in subsection 3.1.1 is filed between the date one year from the date of this Agreement and the date two years from the date of this Agreement, the UTS Holders may only request registration for the greater of (i) 97,143 shares of the UTS Registrable Securities and (ii) 194,286 shares of the UTS Registrable

Securities minus any amount previously sold upon the exercise of registration rights contained in subsection 2.1.4 or this subsection 3.1. The UTS Holders shall not be provided the opportunity to participate in any Registration effected (i) during the period prior to the issuance of financial statements reporting 30 days' combined operations of UTS and the Company or (ii) after the date two years from the date of this Agreement. In addition, the Company shall have no obligation to register any Registrable Securities on behalf of the UTS Holders pursuant to this subsection 3.1 unless such securities have a reasonably anticipated aggregate offering price to the public equal to or greater than \$100,000 (U.S.).

### 3.2 UNDERWRITING IN PIGGYBACK REGISTRATION

#### 3.2.1 NOTICE OF UNDERWRITING IN PIGGYBACK REGISTRATION

If the Registration of which the Company gives notice is for a Registered public offering involving an underwriting, the Company shall so advise the Holders as a part of the written notice given pursuant to subsection 3.1. In such event the right of any Holder to Registration shall be conditioned upon such underwriting and the inclusion of such Holder's Registrable Securities in such underwriting to the extent provided in this Section 3. All Holders proposing to distribute their securities through such underwriting shall (together with the Company and the other holders distributing their securities through such underwriting) enter into an underwriting agreement with the Underwriter's Representative for such offering.

#### 3.2.2 MARKETING LIMITATION IN PIGGYBACK REGISTRATION

In the event the Underwriter's Representative advises the Company that market factors require a limitation of the number of shares to be underwritten, the Underwriter's Representative may (subject to the allocation priority set forth in subsection 3.2.3) exclude those Registrable Securities in excess of 10% of the shares to be Registered.

#### 3.2.3 ALLOCATION OF SHARES IN PIGGYBACK REGISTRATION

In the event that the Underwriter's Representative limits the number of shares to be included in a Registration pursuant to subsection 3.2.2, the number of shares to be included in such Registration shall be allocated (subject to subsection 3.2.2) in the following manner. The shares (other than Registrable Securities) held by officers and directors of the Company, other than UTS Registrable Securities held by Stuart Edward White, shall be excluded from such registration and underwriting to the extent required by such limitation. If a limitation on the number of shares is still required after such exclusion, the number of shares that may be included in the Registration and underwriting shall be allocated among all other holders thereof in proportion, as nearly as practicable, to the respective amounts of securities

(including Registrable Securities) which such holders, absent any such limitation, would otherwise be entitled to include in such Registration.

### 3.2.4 WITHDRAWAL IN PIGGYBACK REGISTRATION

If any Holder of Registrable Securities, or a holder of other securities entitled (upon request) to be included in such Registration disapproves of the terms of any such underwriting, such person may elect to withdraw therefrom by written notice to the Company and the underwriter delivered at least one day prior to the effective date of the Registration Statement. The Registrable Securities so withdrawn shall also be withdrawn from the Registration Statement.

### 3.3 BLUE SKY IN PIGGYBACK REGISTRATION

In the event of any Registration of Registrable Securities pursuant to this Section 3, the Company will exercise its best efforts to register and qualify the securities covered by the Registration Statement under such other securities or "blue sky" laws of such jurisdictions as shall be requested by the Underwriter's Representative and reasonably appropriate for the distribution of such securities; provided, however, that (i) the Company shall not be required to qualify to do business or to file a general consent to service of process in any such states or jurisdictions and (ii) notwithstanding anything in this Agreement to the contrary, in the event any jurisdiction in which the securities shall be qualified imposes a nonwaivable requirement that expenses incurred in connection with the qualification of the securities be borne by selling shareholders, such expenses shall be payable pro rata by selling shareholders.

## SECTION 4. EXPENSES OF REGISTRATION

All Registration Expenses incurred in connection with all Registrations pursuant to Section 2 (other than a Registration on Form S-3 or a Registration pursuant to subsection 2.1.4) and all Registrations pursuant to Section 3 shall be borne by the Company. All Registration Expenses incurred in connection with any registration, qualification, or compliance pursuant to a Registration on Form S-3 or pursuant to a Registration pursuant to subsection 2.1.4 shall be apportioned among the Company and the Holders of the securities so Registered on the basis of the number of shares so Registered by the Company and such Holders. All Selling Expenses shall be borne by the Holders of the securities Registered pro rata on the basis of the number of shares Registered.

## SECTION 5. REGISTRATION PROCEDURES

The Company will keep each Holder whose Registrable Securities are included in any Registration pursuant to this Agreement advised as to the initiation and completion of such Registration. At its expense the Company will: (i) use its best efforts to keep such Registration effective for a period of 120 days or until the Holder or Holders have completed the distribution described in the Registration Statement relating thereto, whichever first

occurs; and (ii) furnish such number of prospectuses (including preliminary prospectuses) and other documents as a Holder from time to time may reasonably request.

#### SECTION 6. INFORMATION FURNISHED BY HOLDER

It shall be a condition precedent to the Company's obligations under this Agreement that each Holder of Registrable Securities included in any Registration furnish to the Company such information regarding such Holder and the distribution proposed by such Holder or Holders as the Company may reasonably request.

#### SECTION 7. INDEMNIFICATION

##### 7.1 THE COMPANY'S INDEMNIFICATION OF HOLDERS

To the extent permitted by law, the Company will indemnify each Holder, each of its officers, directors and constituent partners, each legal counsel and independent accountant for such Holder, and each person controlling such Holder, with respect to which qualification or compliance of Registrable Securities has been effected pursuant to this Agreement, and each underwriter, if any, and each person who controls any underwriter against all claims, losses, damages, and liabilities (or actions in respect thereof) to the extent such claims, losses, damages, or liabilities arise out of or are based upon any untrue statement (or alleged untrue statement) of a material fact contained in any such Registration Statement, prospectus, offering circular or other document or upon any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, or any violation by the Company of any rule or regulation promulgated under the Securities Act applicable to the Company and relating to action or inaction required of the Company in connection with any such Registration, qualification, or compliance. The Company will reimburse each such Holder, each of its officers, directors and constituent partners, legal counsel and independent accountants, each such underwriter, and each person who controls any such Holder or underwriter, for any legal and any other expenses reasonably incurred in connection with investigating or defending any such claim, loss, damage, liability, or action; provided, however, that the indemnity contained in this subsection 7.1 shall not apply to amounts paid in settlement of any such claim, loss, damage, liability, or action if settlement is effected without the consent of the Company (which consent shall not unreasonably be withheld) and provided, further, that the Company will not be liable in any such case to the extent that any such claim, loss, damage, liability or expense arises out of or is based on any untrue statement or omission based upon written information furnished to the Company by such Holder, underwriter, legal counsel, independent accountant or controlling person and stated to be for use in connection with the offering of securities of the Company; provided, however, that the obligations of the Company hereunder shall be limited to an amount equal to the proceeds of the Registrable Securities sold in such Registration, qualification or compliance.

## 7.2 HOLDER'S INDEMNIFICATION OF THE COMPANY

To the extent permitted by law, each Holder will, if Registrable Securities held by such Holder are included in the securities as to which such Registration, qualification or compliance is being effected pursuant to this Agreement, indemnify the Company, each of its directors and officers, each legal counsel and independent accountant of the Company, each underwriter, if any, of the Company's securities covered by such a Registration Statement, each person who controls the Company or such underwriter within the meaning of the Securities Act, and each other such Holder, each of its officers, directors, and constituent partners and each person controlling such other Holder, against all claims, losses, damages, and liabilities (or actions in respect thereof) to the extent such claims, losses, damages or liabilities arise out of or are based upon any untrue statement (or alleged untrue statement) of a material fact contained in any such Registration Statement, prospectus, offering circular, or other document, or any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, and will reimburse the Company, such Holders, such directors, officers, partners, persons, law and accounting firms, underwriters, or control persons for any legal or any other expenses reasonably incurred in connection with investigating or defending any such claim, loss, damage, liability, or action, in each case to the extent, but only to the extent, that such untrue statement or alleged untrue statement or omission (or alleged omission) is made in such Registration Statement, prospectus, offering circular, or other document in reliance upon and in conformity with written information furnished to the Company by such Holder and stated to be specifically for use in connection with the offering of securities of the Company; provided, however, that the obligations of such Holders hereunder shall be limited to an amount equal to the proceeds to each such Holder of Registrable Securities sold in such Registration, qualification or compliance.

## 7.3 INDEMNIFICATION PROCEDURE

Promptly after receipt by an indemnified party under this Section 7 of notice of the commencement of any action, such indemnified party will, if a claim in respect thereof is to be made against an indemnifying party under this Section 7, notify the indemnifying party in writing of the commencement thereof and generally summarize such action. The indemnifying party shall have the right to participate in and to assume the defense of such claim; provided, however, that the indemnifying party shall be entitled to select counsel for the defense of such claim with the approval of any parties entitled to indemnification, which approval shall not be unreasonably withheld. In the event that the indemnifying party elects to assume the defense of any such suit and retain such counsel and if the indemnified party reasonably determines that a conflict exists between the indemnifying party and the indemnified party in such defense, the indemnifying party shall pay the reasonable fees and expenses of one additional counsel with respect to each such suit retained by the indemnified party selected by the indemnified party (which selection shall be made by a majority in interest of the indemnifying Holders in the case of the Holders) and reasonably satisfactory to

the indemnifying party. The failure to notify an indemnifying party promptly of the commencement of any such action, if prejudicial to the ability of the indemnifying party to defend such action, shall relieve such indemnifying party of any liability to the indemnified party under this Section 7, but the omission so to notify the indemnifying party will not relieve such party of any liability that such party may have to any indemnified party otherwise than under this Section 7.

SECTION 8. LIMITATIONS ON REGISTRATION RIGHTS GRANTED TO OTHER SECURITIES

From and after the date of this Agreement, the Company shall not, without the written consent of Holders of at least 66-2/3% of the Registrable Securities, enter into any agreement with any holder or prospective holder of any securities of the Company that such holder or prospective holder may require the Company to initiate any Registration of any securities of the Company; provided, however, that this Section 8 shall not limit the right of the Company to enter into an agreement with any holder or prospective holder of any securities of the Company that upon any registration of any of its securities, the Company will include among the securities which it then registers securities owned by such holder; and provided, further, that nothing in this Section 8 or this Agreement shall prohibit or limit the right of a holder of Common Stock of the Company to Register or sell its shares of Common Stock.

SECTION 9. TRANSFER AND TERMINATION OF REGISTRATION RIGHTS

The rights to cause the Company to Register securities granted by the Company under this Agreement to the Holders may be assigned by them to a transferee or assignee of any Registrable Securities not sold to the public; provided, however, that (i) such transferee or assignee acquires record or beneficial ownership of not less than 100,000 of the shares of Registrable Securities, (ii) NorAm may not transfer or assign any rights under this Agreement except in connection with the sale or transfer by NorAm of all Registrable Securities issued to it if such sale or transfer is in compliance with the restrictions on a sale or transfer set forth in the NorAm Merger Agreement but only if such restrictions are applicable at the time of the sale or transfer and (iii) the rights of the UTS Holders under this Agreement are not transferable. Notwithstanding any other provision of this Agreement; the rights of the Holders, other than the UTS Holders, to cause the Company to Register Registrable Securities under this Agreement shall terminate in all respects ten years after the date of the closing of the Company's first Registration. The rights of the UTS Holders to cause the Company to Register UTS Registrable Securities under this Agreement shall terminate in all respects two years from the date of this Agreement.

SECTION 10. SUCCESSORS AND ASSIGNS

Subject to the limitations of Section 9, this Agreement shall bind and inure to the benefit of the Company, the Holders and their respective successors and assigns.

## SECTION 11. ENTIRE AGREEMENT

This Agreement contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior arrangements and understandings with respect thereto.

## SECTION 12. NOTICES

All notices, requests, consents and other communications hereunder to any party shall be deemed to be sufficient if contained in a written instrument delivered in person or duly sent by first class registered or certified mail, postage prepaid, addressed to such party at the address set forth below, or such other address as may hereafter be designated in writing by the addressee to the addressor listing all parties:

(a) If to the Company:

Itron, Inc.  
2818 N. Sullivan Rd.  
P.O. Box 15288  
Spokane, WA 99215  
Attention: President

(b) If to the Holders, at their respective addresses set forth on Schedule A hereto.

## SECTION 13. CHANGES

The terms and provisions of this Agreement may not be modified or amended, or any of the provisions hereof waived, temporarily or permanently, except pursuant to the written consent of the Company and the Holders of 66-2/3% of the Registrable Securities then outstanding. Notwithstanding the foregoing, in no event may subsection 2.1.3 of this Agreement be amended without the written consent of NorAm, nor may subsections 2.1.4, 1(j) and (k) and 3.1.2 of this Agreement be amended without the written consent of the UTS Holders holding a majority of the UTS Registrable Securities then outstanding. In addition, in no event may the portions of subsections 1(d) and (f), 2.5.4, 2.7, 3.2.3, 4, 9 and 13 of this Agreement that specifically refer and relate to the UTS Holders, and not all Holders, be amended without the written consent of the UTS Holders holding a majority of the UTS Registrable Securities then outstanding.

## SECTION 14. COUNTERPARTS

This Agreement may be executed in any number of counterparts, and each such counterpart hereof shall be deemed to be an original instrument, but all such counterparts together shall constitute but one agreement.

## SECTION 15. HEADINGS

The headings of the various sections of this Agreement have been inserted for convenience of reference only and shall not be deemed to be a part of this Agreement.

SECTION 16. GOVERNING LAW

This Agreement shall be governed by and construed in accordance with the laws of the State of Washington.

IN WITNESS WHEREOF, the undersigned have executed this Amended and Restated Registration Rights Agreement as of the date set forth above.

Company: ITRON, INC.

/s/ Johnny M. Humphreys  
-----  
Johnny M. Humphreys, President

Holder: NORAM ENERGY CORP.

By /s/ Michael B. Bracy  
-----  
Its Executive Vice President

BG HOLDINGS, INC.

By  
-----  
Its  
-----

CENTRA GAS INC.

By /s/ Graham M. Wilson  
-----  
Its  
-----

KPL LIMITED PARTNERS, INC.

By \_\_\_\_\_  
Its \_\_\_\_\_

SOUTHERN ELECTRIC plc

By \_\_\_\_\_  
Its \_\_\_\_\_

/s/ Stuart Edward White  
\_\_\_\_\_  
Stuart Edward White

/s/ David C. Godwin  
\_\_\_\_\_  
David C. Godwin

/s/ John A. Smith, Jr.  
\_\_\_\_\_  
John A. Smith, Jr.

## SCHEDULE A

NorAm Energy Corp.  
Attn: Michael B. Bracy  
P.O. Box 2628  
Houston, TX 77252

BG Holdings, Inc.  
Attn: Cynthia Masters  
1100 Louisiana St., Suite 2500  
Houston, Texas 77002

Centra Gas Inc.  
Attn: Mr. Graham M. Wilson  
Suite 3400, Park Place  
666 Burrard St.  
Vancouver, BC V6C 3M8, Canada

KPL Limited Partners, Inc.  
c/o Astra Resources  
Attn: Mr. Bob Cline  
1021 Main Street, Suite 1270  
Houston, TX 77002

Southern Electric plc  
Attn: Mr. Stuart Broomfield  
Littlewick Green, Maidenhead  
Berkshire SL6 3QB  
England

Stuart Edward White  
1116 Silver Oaks Court  
Raleigh, NC 27614

David C. Godwin  
7016 North Ridge Drive  
Raleigh, NC 27615

John A. Smith, Jr.  
800 Lake Forest Drive  
Raleigh, NC 27615

## PARTIES TO INDEMNIFICATION AGREEMENTS

Marilyn R. Blair  
Michael B. Bracy  
Jemima G. Brennan  
Jon E. Eliassen  
Robert A. Frati  
Richard G. Geiger  
Johnny M. Humphreys  
Klaus O. Huschke  
Keith N. Hylton  
Michael J. O'Callaghan  
Larry A. Panattoni  
Paul A. Redmond  
Graham M. Wilson  
Robert D. Neilson  
Ted C. DeMerritt  
Mary Ann Peters  
Russell E. Vanos  
Carl R. Aron  
David G. Remington  
Stuart Edward White  
LeRoy W. Nosbaum  
Douglas C. Ralphs  
J. Michael Quinlivan

## LOAN AGREEMENT

BETWEEN

ITRON, INC.,

AS BORROWER,

AND

BANK OF AMERICA NW, N.A.

AND

WASHINGTON TRUST BANK,

AS LENDERS,

AND

BANK OF AMERICA NW, N.A.,

AS AGENT.

DATED AS OF THE 1ST DAY OF JULY, 1996

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## LOAN AGREEMENT

THIS LOAN AGREEMENT (this "Agreement") is dated as of July 1, 1996, between BANK OF AMERICA NW, N.A., doing business as Seafirst Bank, and WASHINGTON TRUST BANK, as Lenders, BANK OF AMERICA NW, N.A., doing business as Seafirst Bank, as agent for Lenders ("Agent"), and ITRON, INC., as Borrower, and renews, restates, and replaces the Loan Agreement between the parties (Bank of America NW, N.A. being the successor by name change to Seattle-First National Bank effective March 1, 1996) dated April 30, 1992 (as subsequently amended, the "Prior Loan Agreement"). For mutual consideration, Lenders, Borrower, and Agent enter into this Agreement.

ARTICLE 1  
DEFINITIONS

1.1 Certain Defined Terms. As used in this Agreement, the following terms have the following meanings, which apply to both the singular and plural forms of the terms defined:

"Agent" means Bank of America NW, N.A. in its capacity as agent for Lenders.

"Applicable Interest Period" means, with respect to any Loan, the period commencing on the date such Loan was made pursuant to Section 2.2 or converted or continued pursuant to Section 2.5 and ending:

(a) At the end of the Commitment Period in the case of a Prime Rate Loan;

(b) 30, 90 or 180 days thereafter in the case of a CD Loan as specified in the Notice of Borrowing or Notice of Refinancing given by Borrower in respect of such Loan;

(c) one, two, three or six months thereafter in the case of a LIBOR Loan as specified in the Notice of Borrowing or Notice of Refinancing given by Borrower in respect of such Loan;

provided, however, that no Applicable Interest Period may end later than the expiration of the Commitment Period.

"Applicable Interest Rate" means, for each Loan (or portion of a Loan), the Prime Rate, the CD Rate, or the LIBOR Rate as designated by Borrower and specified in the Notice of Borrowing or the Notice of Refinancing given with respect to that Loan (or portion of a Loan) or as otherwise determined pursuant to Section 2.5.

"Assessment Rate" for any Applicable Interest Period shall mean for any date the minimum annual percentage rate

established by the Federal Deposit Insurance Corporation (or any successor) for the assessment due from members of the Bank Insurance Fund (or any successor) in effect for the assessment period during which said day occurs based on deposits maintained at such members' offices located in the United States.

"Available Commitment" has the meaning defined in Section

2.1.

"Borrower" means Itron, Inc., a Washington corporation, and any Successor.

"Business Day" means a day, other than Saturday or Sunday, on which banks are open for business in Seattle, Washington.

"CD Loan" means a Loan bearing interest at the CD Rate.

"CD Rate" means an interest rate per annum equal to the sum of (a) the CD Spread and (b) the product arrived at by multiplying the Fixed CD Rate in effect for the Applicable Interest Period by Statutory Reserves in effect on the day as of which such Fixed CD Rate is determined for any Applicable Interest Period, plus (c) the Assessment Rate in effect on the day as of which such Fixed CD Rate is determined for any Applicable Interest Period.

For purposes hereof, the term "CD Spread" shall be as set forth below depending upon the ratio of Total Liabilities to Tangible Capital, which ratio shall be determined by the most recently delivered quarterly financial statements of Borrower. Any change in the ratio, as reflected in a newly-delivered quarterly financial statement, causing the CD Spread to increase or decrease, shall become effective retroactively to the first day of the quarter following the quarter being reported on, and shall change the CD Spread on each CD Loan outstanding, in addition to each CD Loan subsequently created:

Total Liabilities to Tangible Capital	CD Spread
Greater than .50 to 1	1.125% per annum
Less than or equal to .50 to 1	1.000% per annum

For purposes hereof, the term "Fixed CD Rate" shall mean for any Applicable Interest Period that per annum rate, calculated on the basis of actual number of days elapsed over a year of 360 days, set forth as the rate in effect as of the first day of the Applicable Interest Period for a period equal to the Applicable Interest Period in the weekly statistical release H.15(519) published by the Board of Governors of the Federal Reserve System under the caption "CDs (Secondary Market)", or, if said rate is not published as of the first day of the Applicable

Interest Period, the rate for a period equal to the Applicable Interest Period appearing as of said date under the caption "Certs of Deposit" on the display designated as "Page 120" on the Telerate Service (or such other page as may replace Page 120 on such service or, if none, such other available service displaying a composite of rates offered for U.S. Dollar Certificates of Deposit as reported by the Federal Reserve System). If there is no period equal to the Applicable Interest Period on the display, the Fixed CD Rate shall be determined by straight-line interpolation to the nearest month (or week or day if expressed in weeks or days) corresponding to the Applicable Interest Period between the two nearest neighboring periods on the display.

For purposes hereof, "Statutory Reserves" shall mean a fraction (expressed as a decimal), the numerator of which is the number one and the denominator of which is the number one minus the aggregate of the maximum reserve percentages (including, without limitation, any marginal, special, emergency or supplemental reserves) expressed as a decimal established by the Board of Governors of the Federal Reserve System and any other banking authority to which Agent is subject for determining the reserve requirements of Agent in respect of new negotiable time deposits in dollars of over \$100,000 with maturities approximately equal to the Applicable Interest Period, such reserve requirements including, without limitation, those imposed under Regulation D of such Board of Governors. Statutory Reserves shall be adjusted automatically on and as of the effective date of any change in such percentage.

"Code" means the Internal Revenue Code of 1986, as amended from time to time.

"Commitment" and "Commitment Period" have the meanings defined in Section 2.

"Controlled Group" means all members of a controlled group of corporations and all trades or businesses (whether or not incorporated) under common control which, together with Borrower, are treated as a single employer under Section 414(b) or 414(c) of the Code.

"Effective Date" means July 1, 1996.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended from time to time.

"Event of Default" has the meaning defined in Section 7.1.

"Government Approval" means an approval, permit, license, authorization, certificate, or consent of any Governmental Authority.

"Governmental Authority" means the government of the United States or any State or any foreign country or any

political subdivision of any thereof or any branch, department, agency, instrumentality, court, tribunal or regulatory authority which constitutes a part or exercises any sovereign power of any of the foregoing.

"Indebtedness" means for any person (i) all items of indebtedness or liability (except capital, surplus, deferred credits and reserves, as such) which would be included in determining total liabilities as shown on the liability side of a balance sheet as of the date as of which indebtedness is determined, (ii) indebtedness secured by any Lien, whether or not such indebtedness shall have been assumed, (iii) any other indebtedness or liability for borrowed money or for the deferred purchase price of property or services for which such person is directly or contingently liable as obligor, guarantor, or otherwise, or in respect of which such person otherwise assures a creditor against loss, and (iv) any other obligations of such person under leases which shall have been or should be recorded as capital leases.

"Lenders" mean Bank of America NW, N.A., doing business as Seafirst Bank (in its separate capacity, "Seafirst") and Washington Trust Bank, and any Successors.

"LIBOR Loan" means any portion of a Loan bearing interest at the LIBOR Rate.

"LIBOR Rate" shall mean, with respect to any LIBOR Loan for any Applicable Interest Period, an interest rate per annum (rounded upwards, if necessary, to the next 1/16 of 1%) equal to the sum of (a) the LIBOR Spread and (b) the product of (i) the Euro-dollar Rate in effect for such Applicable Interest Period and (ii) Euro-dollar Reserves in effect on the first day of such Applicable Interest Period.

For purposes hereof, the term "LIBOR Spread" shall be as set forth below depending upon the ratio of Total Liabilities to Tangible Capital, which ratio shall be determined by the most recently delivered quarterly financial statements of Borrower. Any change in the ratio, as reflected in a newly-delivered quarterly financial statement, causing the LIBOR Spread to increase or decrease, shall become effective retroactively to the first day of the quarter following the quarter being reported on, and shall change the LIBOR Spread on each LIBOR Loan outstanding, in addition to each LIBOR Loan subsequently created:

Total Liabilities to Tangible Capital	LIBOR Spread
Greater than .50 to 1	1.000% per annum
Less than or equal to .50 to 1	0.875% per annum

For purposes hereof, the term "Euro-dollar Rate" shall be determined on the basis of the offered rate for deposits in U.S.

Dollars for the Applicable Interest Period commencing on the first day of such Applicable Interest Period (the "Reset Date") which appears on the display designated as the "LIBO" page on the Reuter Monitor Money Rates Service (or such other page as may replace the LIBO page on that service for the purpose of displaying London interbank offered rates of major banks) as of 11:00 a.m., London time, on the day that is two Business Days preceding the Reset Date. If at least two such offered rates appear on such Reuter's screen LIBO page, the Euro-dollar Rate in respect of that Reset Date will be the arithmetic means of such offered rates. If fewer than two offered rates appear, the Euro-dollar Rate will be the British Bankers' Association interest settlement rate at 11:00 a.m., London time, on the day that is two Business Days preceding the Reset Date, as reported on page 3750 of Telerate Systems, Inc. under the U.S. dollar column. If no such rate is available, the Euro-dollar Rate will be determined on the basis of the rates at which deposits in U.S. Dollars are offered by four major banks (selected by Agent) in the London interbank market at approximately 11:00 a.m., London time, on the day that is two Business Days preceding the Reset Date to prime banks in the London interbank market for the Applicable Interest Period. Agent will request the principal London office of each of the four banks to provide a quotation of its rate. The Euro-dollar Rate will be the arithmetic means of the quotations.

For purposes hereof, the term "Euro-dollar Reserves" means a fraction (expressed as a decimal), the numerator of which is the number one and the denominator of which is the number one minus the aggregate of the maximum reserve percentages (including, without limitation, any special, supplemental, marginal or emergency reserves) expressed as a decimal established by the Board of Governors of the Federal Reserve System and any other banking authority to which Agent is subject, for Eurocurrency Liability (as defined in Regulation D of such Board of Governors). Euro-dollar Reserves shall be adjusted automatically on and as of the effective date of any change in any reserve percentage.

"Lien" means, for any person, any security interest, pledge, mortgage, charge, assignment, hypothecation, encumbrance, attachment, garnishment, execution or other voluntary or involuntary lien upon or affecting the revenues of such person or any real or personal property in which such person has or hereafter acquires any interest, except (i) liens for Taxes which are not delinquent or which remain payable without penalty or the validity or amount of which is being contested in good faith by appropriate proceedings upon stay of execution of the enforcement thereof; (ii) liens imposed by law (such as mechanics' liens) incurred in good faith in the ordinary course of business which are not delinquent or which remain payable without penalty or the validity or amount of which is being contested in good faith by appropriate proceedings upon stay of execution of the enforcement thereof; and (iii) deposits or pledges under workmen's compensation, unemployment insurance, social security or other

similar laws or made to secure the performance of bids, tenders, contracts (except for repayment of borrowed money), or leases, or to secure statutory obligations or surety or appeal bonds or to secure indemnity, performance or other similar bonds given in the ordinary course of business.

"Loan" means a loan by Lenders to Borrower pursuant to Article 2.

"Loan Documents" means this Agreement, the Notes, and all amendments, modifications and renewals to those documents.

"Material Subsidiary" means any Subsidiary which, because of its size or the nature of its business, is material to the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole. The Subsidiaries that are Material Subsidiaries as of the Closing Date are described on Exhibit D.

"Note" and "Notes" have the meaning defined in Section 2.6.

"Notice of Borrowing" has the meaning defined in Section 2.2 and shall be in the form attached hereto as Exhibit A.

"Notice of Refinancing" has the meaning defined in Section 2.5 and shall be in the form attached hereto as Exhibit B.

"Outsourcing Contracts" means contracts or arrangements in which Borrower, either directly or through Subsidiaries, performs meter reading and other services for a utility in return for a fixed amount over a period of time, either directly or through joint ventures with utilities and other industry participants.

"PBGC" means the Pension Benefit Guaranty Corporation or any entity succeeding to any or all of its functions under ERISA.

"Pension Plan" or "Plan" shall mean, at any time, an employee pension benefit plan which is covered by Title IV of ERISA or subject to the minimum funding standards under Section 412 of the Internal Revenue Code and is either (a) maintained by Borrower or any member of a Controlled Group for employees of Borrower or any member of such Controlled Group, or (b) maintained pursuant to a collective bargaining agreement or any other arrangement under which more than one employer makes contributions and to which Borrower or any member of a Controlled Group is then making or accruing an obligation to make contributions or has within the preceding 5 plan years made contributions.

"Potential Event of Default" means an act, action or event set forth in Article 7 which would constitute an Event of Default except that the notice required by Article 7 has not been given or the cure period set forth in Article 7 has not expired.

"Prime Rate" means an interest rate per annum equal to the higher of:

(A) the publicly announced prime rate charged on that day by Agent at its principal office (which prime rate is a reference rate and not necessarily the lowest rate of interest charged by Agent to its prime customers), changing as such prime rate changes, or

(B) the sum of 1.50% plus the "Federal Funds" rate, as quoted by Garvin Guybutler on page 5 of Telerate on such day (or if said broker or Telerate shall cease to quote or report the "Federal Funds" rate, the "Federal Funds" rate shall be as quoted by another broker and as reported on any other electronic or printed medium selected by Agent), changing as such "Federal Funds" rate changes.

"Prime Rate Loan" means a Loan bearing interest at the Prime Rate.

"Pro Rata Share" means 86% as to Bank of America NW, N.A., doing business as Seafirst Bank, and 14% as to Washington Trust Bank.

"Standby Commitment" has the meaning defined in Section 2.1.

"Subordinated Debt" means Indebtedness for borrowed money of Borrower which shall have been subordinated to the Loans and other obligations of Borrower under the Loan Documents, on terms and conditions which provide, in form satisfactory to Agent, that no payments may be made by Borrower in respect of such Indebtedness at any time when an Event of Default or Potential Event of Default shall have occurred and be continuing.

"Subsidiary" means any corporation of which a majority (by number of shares or by number of votes) of any class of outstanding capital stock normally entitled to vote for the election of one or more directors (regardless of any contingency which does or may suspend or dilute the voting rights of such class) is at such time owned directly or indirectly by Borrower or one or more subsidiaries.

"Successor" means, for any corporation or banking association, any successor by merger or consolidation, or by acquisition of substantially all of the assets of the predecessor.

"Tangible Capital" has the meaning defined in Section

5.13.

"Total Liabilities" has the meaning defined in Section

5.13.

"Unfunded Vested Liabilities" means, with respect to any Plan, at any time, the amount (if any) by which (a) the present value of all vested nonforfeitable benefits under such Plan exceeds (b) the fair market value of all Plan assets allocable to such benefits, all determined as of the then most recent valuation date for such Plan, but only to the extent that such excess represents a potential liability of Borrower or any member of the Controlled Group to the PBGC or the Plan under Title IV of ERISA.

1.2 Accounting Terms. Except as otherwise provided herein, accounting terms not specifically defined shall be construed, and all accounting procedures shall be performed, in accordance with generally accepted United States accounting principles consistently applied.

ARTICLE 2  
THE CREDIT

2.1 The Revolving Credit. Each Lender severally agrees on the terms and conditions of this Agreement to make revolving loans to Borrower (the "Loans") from time to time on Business Days during the period beginning on the Effective Date and ending on May 31, 1997 (the "Commitment Period"), provided that after giving effect to any such Loan the aggregate unpaid principal amount of all such Loans made by such Lender shall not exceed at any time such Lender's Pro Rata Share of the sum of the "Available Commitment" plus the "Standby Commitment" as set forth below (the "Commitment"):

Time Period -----	Available Commitment -----	Standby Commitment -----
Effective Date through 9/29/96	\$20,000,000	\$30,000,000
9/30/96 through 12/30/96	\$30,000,000	\$20,000,000
After 12/30/96	\$50,000,000	\$0

If at any time any portion of the Standby Commitment is used as a Loan, the "Available Commitment" shall be permanently increased by, and the "Standby Commitment" shall be permanently reduced by, the dollar amount of each such Loan, for each time period specified above. The Loans described in this Section 2.1 constitute a revolving credit and, subject to the terms and

conditions hereof, within the amount and time specified Borrower may pay, prepay and reborrow. Each Loan requested by Borrower under this Section 2.1 shall be in an amount (for both Lenders combined) of not less than \$250,000 if such Loan or advance is a Prime Rate Loan and not less than \$500,000 if such Loan is a CD Loan or a LIBOR Loan.

2.2 Manner of Borrowing. Borrower shall give Agent at least same Business Day's written notice (by telecopy or otherwise) of each intended borrowing of a Prime Rate Loan, and at least one (1) Business Day's written notice (by telecopy or otherwise) of each intended borrowing of a CD Loan, and at least two (2) Business Day's written notice (by telecopy or otherwise) of each intended borrowing of a LIBOR Loan. Each such notice (herein a "Notice of Borrowing") shall be in the form of Exhibit A and shall specify the date of the intended borrowing, and the initial Applicable Interest Rate and Applicable Interest Period selected by Borrower in respect of the anticipated Loan. Each Notice of Borrowing shall be effective upon receipt, except that notices received by Agent after 11:00 a.m., Seattle time, on a Business Day shall be deemed to be received on the immediately succeeding Business Day. All such notices shall be irrevocable and shall constitute a representation and warranty by Borrower that as of the date of the notice the statements set forth in Article 4 hereof are true and correct and that no Event of Default or Potential Event of Default shall have occurred and be continuing. on receipt of such Notice of Borrowing, Agent shall promptly (on the same day, if possible) notify each Lender by telephone (confirmed promptly by telex or telecopy), telex or telecopy of the information set forth in the Notice of Borrowing. Each Lender shall before 2:00 p.m. Seattle time on the specified date of borrowing pay such Lender's pro rata share of the requested borrowing in Seattle clearinghouse funds to Agent at its Commercial Loan Service Center. Upon fulfillment to Agent's satisfaction of the applicable conditions set forth in Article 3, and after receipt by Agent of such funds, Agent will make such funds available to Borrower. The initial Loan will be in an amount equal to or greater than the amount necessary to repay all amounts then outstanding under the Prior Loan Agreement and shall be used to repay all amounts then outstanding under the Prior Loan Agreement. If the initial Loan is greater than the amount necessary to repay all amounts then outstanding under the Prior Loan Agreement, the excess amount after repayment shall be disbursed to the ordinary checking account maintained by Borrower at Agent's Commercial Accounts Service Center. All future Loans shall be disbursed to the ordinary checking account maintained by Borrower at Agent's Commercial Accounts Service Center.

Each Lender may, at its option, fund its own Commitment hereunder notwithstanding any default by the other Lender in advancing its Commitment. In such event, Agent shall thereafter take such disproportionate funding into account in allocating principal and interest repayments to Lenders. The foregoing right of a Lender to advance funds in spite of the other Lender's

default shall not prejudice or limit in any respect the rights of such Lender or Borrower against the defaulting Lender.

2.3 Repayment of Principal. Borrower shall repay to Lender the principal amount of the Loans on or before the last day of the Commitment Period.

2.4 Interest.

(a) Borrower agrees to pay interest on the unpaid principal amount of each Loan from the date of the Loan until the end of the Commitment Period at the Applicable Interest Rate and thereafter at a rate which is three (3) percentage points per annum above the Prime Rate (changing as the Prime Rate changes). Accrued but unpaid interest on each Loan shall be paid (i) as to Prime Rate Loans, on the first day of each calendar month for the period ending on the last day of the preceding calendar month, and (ii) as to CD Loans and LIBOR Loans, on the last day of the Applicable Interest Period and, for Applicable Interest Periods longer than three months, also on the day three months after the first day of the Applicable Interest Period. Notwithstanding the foregoing, accrued interest on any Loan shall be payable on demand after the occurrence of an Event of Default.

(b) In the event, and on each occasion, that Agent shall have determined (which determination shall be conclusive and binding) that the CD Rate or LIBOR Rate cannot be ascertained for any reason (including, without limitation, the inability or failure of Agent to obtain sufficient bids in accordance with the terms of the definition of the CD Rate or LIBOR Rate) or Agent shall determine that due to a change in the financial markets not specifically related to the unique funding capabilities of either Lender the CD Rate or LIBOR Rate will not adequately and fairly reflect the cost to Lenders of making or maintaining the principal amount of a CD Loan or LIBOR Loan during the Applicable Interest Period for such CD Loan or LIBOR Loan, Lender shall, as soon as practicable thereafter, give notice of such determination to Borrower and any request for a CD Loan or LIBOR Loan pursuant to Section 2.2 or for conversion to or continuation of a CD Loan or LIBOR Loan pursuant to Section 2.5 shall be deemed to be a request for a Prime Rate Loan.

2.5 Conversion/Continuation.

(a) Subject to the limitations as to amount and time set forth in the definitions of "Applicable Interest Rate" and "Applicable Interest Period," Borrower shall have the option (i) to convert all or a portion of any LIBOR Loan, CD Loan, or Prime Loan to a Loan bearing interest at a different permissible reference rate, or (ii) at the expiration of the Applicable Interest Period for a CD Loan or a LIBOR Loan, to continue such Loan as a CD Loan or LIBOR Loan for a new Applicable Interest Period; provided, however, (x) no outstanding Loan may be continued as, or be converted into, a CD Loan or a LIBOR Loan when any Potential Event of Default or Event of Default has

occurred and is continuing and (y) a CD Loan or a LIBOR Loan may only be converted at the conclusion of an Applicable Interest Period.

(b) At any time Borrower wishes to cause a conversion or continuation of a Loan pursuant to Paragraph (a) above, Borrower shall deliver (by telecopy or otherwise) a written notice of refinancing (herein a "Notice of Refinancing") in the form of Exhibit B hereto to Agent no later than 11:00 a.m., Seattle time, on a Business Day at least as far in advance of such desired conversion or continuation as would be required if the Loan as converted or continued were being originally made pursuant to Section 2.2. The Notice of Refinancing shall specify: (i) the proposed conversion/continuation date (which shall be a Business Day), (ii) the amount of the Loan to be converted/continued, (iii) the nature of the proposed conversion or continuation, and (iv) in the case of a conversion to, or continuation of, a CD Loan or a LIBOR Loan, the new Applicable Interest Period. A Notice of Refinancing shall be irrevocable and Borrower shall be bound to convert or continue in accordance therewith.

(c) In the event that at the conclusion of an Applicable Interest Period for a CD Loan or a LIBOR Loan, Borrower has not furnished a Notice of Refinancing complying with the terms of this Agreement or, if at such time, Borrower is not entitled to convert a Loan to, or continue it as, a CD Loan or a LIBOR Loan, such Loan shall as of the last day of the expiring Applicable Interest Period be deemed to have been converted to a Prime Rate Loan.

2.6 Promissory Notes. Borrower shall execute and deliver to each Lender on or prior to the Effective Date, a promissory note (for each Lender, the "Note", and, collectively, the "Notes") in the principal amount of such Lender's commitment and otherwise substantially in the form of Exhibit C hereto.

2.7 Prepayment.

(a) Any portion of the principal of a Loan may be paid prior to its maturity (herein a "prepayment"). Any prepayment of principal shall be accompanied by all accrued but unpaid interest on the principal amount prepaid. Absent a designation by Borrower and in any event during the continuance of an Event of Default, prepayments shall be applied to such Loans as shall be designated by Agent, in its sole discretion.

(b) No fee shall be assessed in connection with the prepayment of a Prime Rate Loan. If a CD Loan or a LIBOR Loan is paid prior to the end of the Applicable Interest Period, Borrower shall pay a premium on the date of such payment in an amount determined pursuant to Exhibit 1 hereto. Such premiums shall apply in all circumstances where principal on a LIBOR Loan or a CD Loan is paid prior to the end of the Applicable Interest

Period, regardless of whether such payment is voluntary or mandatory or the result of Agent's collection efforts.

2.8 Manner of Payments; Computations.

(a) Borrower shall have on deposit on the day of any scheduled payments hereunder sufficient funds in Borrower's Seafirst checking account no. 67130-500 to make such scheduled payments of principal, interest and/or fees on the Loans and Commitments as those amounts become due for payment hereunder and under the related documents. Agent shall give Borrower written notice of the expected amount of interest on CD Loans or LIBOR Loans at least five Business Days prior to the date of each scheduled payment thereof, but will give same-day fax notice of the expected amount of interest payments on Prime Rate Loans. All scheduled payments of principal, interest and/or fees due hereunder by Borrower to Lender shall be made by charging such amounts against Borrower's aforesaid checking account after 11:00 a.m., Seattle time, on the day on which such payments shall become due. All other amounts payable hereunder by Borrower to Agent or Lenders shall be made by paying the same in United States Dollars and in immediately available funds to Agent at its Commercial Loan Service Center not later than 2:00 p.m., Seattle time, on the date on which such payment shall become due.

(b) In addition to the scheduled payment withdrawal authorization set out in paragraph (a) above, Borrower hereby authorizes Agent and each Lender, if and to the extent any payment is not promptly made pursuant to this Agreement or any Note and an Event of Default exists, to charge from time to time against any or all of the accounts of Borrower with Agent or Lenders any amount due hereunder or under any Note.

(c) All computations of fees and of Prime Rate Loan interest shall be made on the basis of a year of 365 or 366 days and all computations of interest on CD Loans and LIBOR Loans shall be made on the basis of a year of 360 days, in either case, for the actual number of days (including the first day but excluding the last day) occurring in the period for which such interest or fees are payable.

(d) Whenever any payment hereunder or under any Note shall be stated to be due or whenever the last day of any Applicable Interest Period would otherwise occur on a day other than a Business Day, such payment shall be made and the last day of such Applicable Interest Period shall occur on the next succeeding Business Day and such extension of time shall in such case be included in the computation of payment of interest or commitment fees, as the case may be; provided, however, in the case of an interest payment due at the end of an Applicable Interest Period on a LIBOR Loan, if such next succeeding Business Day is the first Business Day of a calendar month, such interest payment shall be made on the next preceding Business Day.

2.9 Fees. Borrower agrees to pay to each Lender a commitment fee computed quarterly in arrears, as follows, to be paid fifteen days after the end of each quarter (and fifteen days after the expiration of the Commitment Period, if such expiration should occur on a day other than the end of a quarter):

(a) 0.18% per annum on the average daily unused amount of such Lender's Pro Rata Share of the Available Commitment during the preceding quarter; plus

(b) 0.10% per annum on the average daily unused amount of such Lender's Pro Rata Share of the Standby Commitment during the preceding quarter; plus

(c) 0.08% per annum of such Lender's Pro Rata Share of the principal portion, if any, of the Standby Commitment which converted to "Available Commitment" pursuant to the last paragraph of Section 2.1, calculated retroactively for the 90 days preceding the date upon which such portion of the Standby Commitment was advanced as a Loan to Borrower (but calculated no farther backwards than the Effective Date).

2.10 Sharing of Payments, Etc. If any Lender shall obtain any payment from Borrower (whether voluntary or involuntary through the exercise of any right of setoff or otherwise) in excess of its Pro Rata Share of all payments due Lenders hereunder, such Lender shall hold such excess payment in trust for Agent and shall forthwith remit the same to Agent for distribution to Lenders in accordance with their Pro Rata Shares.

### ARTICLE 3

#### THE EFFECTIVE DATE; CONDITIONS PRECEDENT TO LENDING

3.1 Conditions Precedent to Effective Date. In addition to the conditions set forth in Sections 3.2 and 3.3, the obligation of Lenders to make the initial Loan is subject to fulfillment of the following conditions on or prior to the Effective Date:

(a) Loan Documents. Each Lender shall have received all of the following Loan Documents, each duly executed and delivered by the respective parties thereto, and satisfactory to each Lender in form and substance:

(i) this Agreement;

(ii) the Notes; and

(iii) Certificate signed by the chief executive officer, chief financial officer or other principal financial officer of Borrower, certifying compliance as of the Effective Date with Sections 3.2(b) and (c) hereof.

(b) Corporate Certificates. Agent shall have received all of the following, each satisfactory to Lenders in form and substance:

(i) Certified copies of the articles of incorporation and bylaws of Borrower;

(ii) Certificate of good standing issued by the Secretary of the State of Washington with respect to Borrower;

(iii) Certified copy of resolution adopted by the board of directors of Borrower authorizing the execution, delivery and performance by Borrower of this Agreement and the Notes;

(iv) Incumbency certificates describing the office and identifying the specimen signatures of the individuals signing the Loan Documents on behalf of Borrower.

(c) Other Information. Agent shall have received such other statements, opinions, certificates, documents and information with respect to the matters contemplated by this Agreement as it may reasonably request.

3.2 Conditions to All Loans and to Refinancing. The obligation of Lenders to fund any Loans hereunder, including the initial Loan or to permit any refinancing pursuant to Section 2.5, is subject to fulfillment of the following conditions:

(a) Notice of Borrowing or Refinancing. Agent shall have received the Notice of Borrowing or Notice of Refinancing, as the case may be, in respect of such Loan.

(b) No Default. At the date of the Loan or the refinancing, no Potential Event of Default or Event of Default shall have occurred and be continuing or will occur as a result of the making of the Loans; and the representations of Borrower in Article 4 shall be true on and as of such date with the same force and effect as if made on and as of such date.

(c) Compliance with Quarterly Financial Covenants. At the end of the last calendar quarter preceding such Loan or refinancing, Borrower and its consolidated Subsidiaries were in compliance with Sections 5.12 and 5.13 (applying such covenants as if the Loans being requested were outstanding as of the end of such calendar quarter) and, since the end of such calendar quarter, neither Borrower nor any consolidated Subsidiary has redeemed any equity or repaid any Subordinated Debt which, if they had occurred immediately prior to the end of the calendar quarter, would have resulted in a violation of Sections 5.12 or 5.13 (if there had then been Loans outstanding).

(d) Conditions to the Effective Date. All conditions to the Effective Date shall have been satisfied.

3.3 Effective Date Events. On the Effective Date, subject to satisfaction of the conditions set forth in Section 3.1 and 3.2, the following events will occur:

(a) Return of Prior Notes. Upon satisfaction of Section 3.3(b), Lenders shall mark the promissory notes that were issued under the Prior Loan Agreement "CANCELLED" and shall return same to Borrower (the "Prior Notes").

(b) Payment of Prior Loan Agreement Advances. All accrued but unpaid interest and outstanding principal balances plus payment of any accrued fees under the Prior Notes shall be paid in full.

(c) Termination of Prior Loan Agreement. The Prior Loan Agreement and the Prior Notes shall be deemed terminated and shall be of no further force or effect.

#### ARTICLE 4 REPRESENTATIONS AND WARRANTIES OF BORROWER

Borrower represents and warrants to each Lender as follows:

4.1 Corporate Existence and Power. Borrower and each Subsidiary are corporations duly incorporated, validly existing and in good standing under the laws of their respective jurisdictions of incorporation. Borrower and each Subsidiary are duly qualified to do business in each other jurisdiction where the nature of their respective activities or the ownership of their respective properties requires such qualification, except to the extent that failure to be so qualified does not have a material adverse effect on the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole. Borrower and each Subsidiary have full corporate power, authority and legal right to carry on their business as presently conducted, and to own and operate their properties and assets. Borrower has full corporate power, authority and legal right to execute, deliver and perform all Loan Documents to which it is a party.

4.2 Corporate Authorization. The execution, delivery and performance by Borrower of the Loan Documents and any borrowing hereunder and thereunder (i) have been duly authorized by all necessary corporate action of Borrower, (ii) do not require any shareholder approval or the approval or consent of any trustee or the holders of any Indebtedness of Borrower or any subsidiary except such as have been obtained (certified copies thereof having been delivered to Agent), (iii) do not contravene any law, regulation, rule or order binding on Borrower or any subsidiary or its Articles of Incorporation or Bylaws, and (iv)

do not contravene the provisions of or constitute a default under any indenture, mortgage, contract or other agreement or instrument to which Borrower or any Subsidiary is a party or by which Borrower or any Subsidiary or any of their properties may be bound or affected, except for a contravention or default by a Subsidiary that would not have a material adverse effect on the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole.

4.3 Government Approvals, Etc. No Government Approval or filing or registration with any Governmental Authority is required for the making and performance by Borrower of any Loan Document to which it is a party or in connection with any of the transactions contemplated hereby, except such as have been heretofore obtained and are in full force and effect (certified copies thereof having been delivered to Agent).

4.4 Binding Obligations, Etc. The Loan Documents have been duly executed and delivered by Borrower, and constitute the legal, valid and binding obligations of Borrower enforceable against Borrower in accordance with their respective terms.

4.5 Litigation. There are no actions, proceedings, investigations, or claims against or affecting Borrower or any Subsidiary now pending before any court, arbitrator or Governmental Authority (nor to the knowledge of Borrower has any thereof been threatened nor does any basis exist therefor) which has a reasonable likelihood of being determined adversely to Borrower or any Subsidiary and which, if so determined, would be likely to have a material adverse effect on the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole, or to result in a judgment or order against Borrower or any Subsidiary (in excess of insurance coverage) for more than \$250,000 in any one case or \$500,000 in the aggregate, except as reflected in the financial statements referred to in Section 4.6.

4.6 Financial Condition. The consolidated balance sheet of Borrower and its consolidated Subsidiaries as at December 31, 1995, and the related consolidated statements of income and cash flows of Borrower and its consolidated Subsidiaries for the fiscal year then ended, copies of which have been furnished to each Lender, fairly present the consolidated financial condition of Borrower and its consolidated Subsidiaries as at such date and the results of operations of Borrower and its consolidated Subsidiaries for the period then ended, all in accordance with generally accepted accounting principles consistently applied. Borrower and its consolidated Subsidiaries did not have on such date any contingent liabilities for Taxes, unusual forward or long-term commitments or unrealized or anticipated losses from any unfavorable commitments, except as referred to or reflected or provided for in that balance sheet and in the notes to those financial statements. Since that date, there has been no material adverse change in the business, operations or financial

condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole.

4.7 Title and Liens. Borrower and its Material Subsidiaries have good and marketable title to each of the properties and assets reflected in the balance sheet referred to in Section 4.6 (except such as are held under leases or have been since sold or otherwise disposed of in the ordinary course of business). No assets or revenues of Borrower or its Material Subsidiaries are subject to any Lien except as permitted under Section 6.3. All properties of Borrower and its Subsidiaries and their use thereof comply with applicable zoning and use restrictions and with applicable laws and regulations relating to the environment, except for violations that do not have a material adverse effect upon the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole.

4.8 Taxes. Borrower and its Material Subsidiaries have filed all tax returns and reports required of them, have paid all taxes which are due and payable or as to which there is no good faith contest or dispute as to the amount or validity of the assessment against Borrower and its Material Subsidiaries, and have provided adequate reserves for payment of any tax whose payment is being contested. All Subsidiaries that are not Material Subsidiaries have filed all tax returns and reports required of them, have paid all taxes which are due and payable or as to which there is no good faith contest or dispute as to the amount or validity of the assessment, and have provided adequate reserves for payment of any tax where payment is being contested, except in respect of taxes in an aggregate amount equal to or less than Ten Thousand Dollars (\$10,000). The charges, accruals and reserves on the books of Borrower and its Subsidiaries in respect of taxes for all fiscal periods to date are accurate. There are no questions or disputes between Borrower or any Subsidiary and any Governmental Authority with respect to any taxes except as disclosed in the balance sheet referred to in Section 4.6 or otherwise previously disclosed to both Lenders in writing.

4.9 Other Agreements. Neither Borrower nor any subsidiary is in breach of or default under any material agreement to which it is a party or which is binding on it or any of its assets, the breach of which agreement would have a material adverse effect upon the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole.

4.10 Federal Reserve Regulations. Neither Borrower nor any Subsidiary is engaged principally or as one of its important activities in the business of extending credit for the purpose of purchasing or carrying any margin stock (within the meaning of Federal Reserve Regulation U), and no part of the proceeds of any Loan will be used to purchase or carry any such margin stock or to extend credit to others for the purpose of purchasing or

carrying any such margin stock or for any other purpose that violates the applicable provisions of any Federal Reserve Regulation. Borrower will furnish on request to Agent a statement conforming with the requirements of Regulation U.

4.11 ERISA.

(a) The present value of all benefits vested under all Pension Plans did not, as of the most recent valuation date of such Pension Plans, exceed the value of the assets of the Pension Plans allocable to such vested benefits by an amount which would represent a potential material liability of Borrower and its Material Subsidiaries or affect materially the ability of Borrower to perform its obligations under the Loan Documents.

(b) No Plan or trust created thereunder, or any trustee or administrator thereof, has engaged in a "prohibited transaction" (as such term is defined in Section 406 or Section 2003(a) of ERISA) which could subject such Plan or any other Plan, any trust created thereunder, or any trustee or administrator thereof, or any party dealing with any Plan or any such trust to the tax or penalty on prohibited transactions imposed by Section 502 or Section 2003(a) of ERISA.

(c) No Pension Plan or trust created thereunder has been terminated, and there have been no "reportable events" (as that term is defined in Section 4043 of ERISA) since the effective date of ERISA.

(d) No Pension Plan or trust created thereunder has incurred any "accumulated funding deficiency" (as such term is defined in Section 302 of ERISA) whether or not waived, since the effective date of ERISA.

(e) Neither Borrower nor any Material Subsidiary is now, nor has it been, a party to or had any employees who are covered by any multi-employer pension or benefit plan.

(f) The required allocations and contributions to Pension Plans will not violate Section 415 of the Internal Revenue Code.

4.12 Subsidiaries. In respect of Subsidiaries, Exhibit D to this Agreement sets forth as of the date of this Agreement the authorized capitalization of each Material Subsidiary, the number of shares of each class of capital stock issued and outstanding of each Material Subsidiary, and the number and percentage of outstanding shares of each such class of capital stock owned by Borrower or by any Material Subsidiary, and describes the Material Subsidiaries as of the Closing Date. Exhibit D sets forth the name and address of each Subsidiary and the percentage of outstanding shares owned by Borrower. Borrower will promptly notify Lender in writing of any change in the identity of the Material Subsidiaries, which will be subject to Lenders' approval. The outstanding shares of each Subsidiary have been

duly authorized and validly issued and are fully paid and nonassessable. Borrower and each Subsidiary owns beneficially and of record and has good title to all the shares it is listed as owning on Exhibit D, free and clear of any Lien.

4.13 Representations as a Whole. This Agreement, the financial statements referred to in Section 4.6, and all other instruments, documents, certificates and statements furnished to the Lender by Borrower, taken as a whole, do not contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements contained herein or therein not misleading.

ARTICLE 5  
AFFIRMATIVE COVENANTS OF BORROWER

So long as Lenders shall have any Commitment hereunder and until payment in full of each Loan and Note and performance of all other obligations of Borrower under the Loan Documents, Borrower agrees that all of the following shall be done unless each Lender shall otherwise consent in writing:

5.1 Use of Proceeds. Borrower will use the proceeds of the Loan exclusively for general corporate purposes subject to the provisions of this Agreement.

5.2 Preservation of Corporate Existence, Etc. Borrower will cause to be done all things necessary to preserve and maintain the corporate existence, franchises and privileges of Borrower in Washington, and all other Material Subsidiaries in their respective jurisdictions of incorporation. Borrower will qualify, and thereafter remain qualified, and will cause each Material Subsidiary to qualify and remain qualified as a foreign corporation in each jurisdiction where such qualification is necessary or advisable in view of Borrower's or such Material Subsidiary's business and operations or the ownership of its properties.

5.3 Visitation Rights. At any reasonable time, and from time to time, upon reasonable notice, Borrower will permit Lenders to examine and make copies of and abstracts from the records and books of account of and to visit the properties of Borrower and its Material Subsidiaries and to discuss the affairs, finances and accounts of Borrower and its Material subsidiaries with its chief executive officer, chief financial officer or other principal financial officer, if any.

5.4 Keeping of Books and Records. Borrower will keep and will cause its Subsidiaries to keep adequate records and books of account in which complete entries will be made, in accordance with generally accepted accounting principles consistently applied, reflecting all financial transactions of Borrower and its Subsidiaries.

5.5 Maintenance of Property, Etc. Borrower will maintain and preserve and will cause its Subsidiaries to maintain and preserve all of their properties in good working order and condition, ordinary wear and tear excepted, and Borrower will, and will cause its Subsidiaries to from time to time make all needed repairs, renewals or replacements so that the efficiency of such properties shall be fully maintained and preserved, provided that Borrower shall not be required to comply with this Section 5.5 if failure to comply would not be likely to have a material adverse effect on the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole.

5.6 Compliance with Laws, Etc. Borrower will comply and will cause each Subsidiary to comply in all material respects with all laws, regulations, rules, and orders of Governmental Authorities applicable to Borrower and its subsidiaries or to their operations or property, except any thereof whose validity is being contested in good faith by appropriate proceedings upon stay of execution of the enforcement thereof.

5.7 Other Obligations. Borrower will and will cause each Subsidiary to pay and discharge before the same shall become delinquent all Indebtedness, all taxes and all other obligations for which Borrower or its Subsidiaries are liable or to which their income or property is subject (except to the extent that failure to pay such other obligations would not be likely to have a material adverse effect upon the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole), and all claims for labor and materials or supplies which, if unpaid, might become by law a lien upon assets of Borrower or its Subsidiaries, except any thereof whose validity or amount is being contested in good faith by Borrower or its Subsidiaries in appropriate proceedings with provision having been made to the reasonable satisfaction of Agent for the payment thereof in the event the contest is determined adversely to Borrower or its Subsidiaries.

5.8 Insurance. Borrower will keep and will cause its Material Subsidiaries to keep in force upon all of their properties and operations policies of insurance carried with responsible companies in such amounts and covering all such risks as shall be customary in the industry and reasonably satisfactory to Agent. Borrower will on request furnish to Agent certificates of insurance or duplicate policies evidencing such coverage.

5.9 Financial Information. Borrower will deliver to Agent and to each Lender:

(a) As soon as available and in any event within 100 days after the end of each fiscal year of Borrower, the consolidated balance sheet of Borrower and its consolidated Subsidiaries as of the end of such fiscal year, the related consolidated statements of income, the related consolidated statements of cash flows, and the related consolidated statements

of shareholders' equity of Borrower and its consolidated Subsidiaries for such year, setting forth in comparative form the corresponding consolidated figures for the appropriate periods in the preceding fiscal year, accompanied by an audit report of the consolidated balance sheet, statements of income and cash flows and statement of shareholders' equity of Borrower and its consolidated Subsidiaries for such year by independent certified public accountants selected by Borrower (which reports shall be prepared in accordance with generally accepted accounting principles consistently applied and shall not be qualified by reason of restricted or limited examination of any material portion of Borrower's and the Subsidiaries' records and shall contain no disclaimer of opinion or adverse opinion except such as Lenders in their sole discretion determine to be immaterial);

(b) As soon as available and in any event within 50 days after the end of each of the first three fiscal quarters of Borrower each fiscal year, the internally prepared unaudited consolidated balance sheet and the related consolidated statements of income and cash flows of Borrower and its consolidated Subsidiaries as of the end of such fiscal quarter (and for the period from the beginning of the fiscal year to the end of such fiscal quarter), setting forth in comparative form the corresponding consolidated figures for the appropriate periods in the preceding fiscal year, accompanied by a certificate of the chief executive officer, chief financial officer or other principal financial officer of Borrower that such unaudited consolidated balance sheet and statement of income and cash flows have been prepared in accordance with generally accepted accounting principles consistently applied and present fairly the financial position and the results of operations of Borrower and its consolidated Subsidiaries as of the end of and for such fiscal quarter and that since the fiscal year-end report referred to in clause (a) there has been no material adverse change in the financial condition or operations of Borrower and its consolidated Subsidiaries as shown on the consolidated balance sheet as of said date;

(c) Within 100 days after the close of each fiscal year of Borrower, and within 50 days after the end of each fiscal quarter, a certificate signed by the chief executive officer, chief financial officer, or other principal financial officer of Borrower stating that as of the close of such fiscal year or fiscal quarter, as applicable, no Potential Event of Default or Event of Default has occurred and is continuing;

(d) All other statements, reports and other information as either Lender may reasonably request concerning the financial condition and business affairs of Borrower and its subsidiaries; and

(e) As soon as required to be filed, all 10Ks, 10Qs, 8Ks, annual reports, quarterly reports, and other filings or submittals made to shareholders or to the Securities and Exchange Commission.

5.10 Notification. Promptly after learning thereof, Borrower will notify Agent of (a) the details of any action, proceeding, investigation or claim against or affecting Borrower or any Subsidiary instituted before any court, arbitrator or Governmental Authority or, to Borrower's knowledge threatened to be instituted, which, if determined adversely to Borrower or any Subsidiary would be likely to have a material adverse effect on the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole or to result in a judgment or order against Borrower or any Subsidiary (in excess of insurance coverage) for more than \$250,000 or, when combined with all other pending or threatened claims, more than \$500,000; (b) any substantial dispute between Borrower or any Subsidiary and any Governmental Authority which, if determined adversely to Borrower or any Subsidiary would be likely to have a material adverse effect on the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole; (c) any labor controversy which has resulted in or, to Borrower's knowledge, threatens to result in a strike which would materially affect the business operations of Borrower; (d) if Borrower or any member of the Controlled Group gives or is required to give notice to the PBGC of any "reportable event" (as defined in subsections (b)(1), (2), (5) or (6) of Section 4043 of ERISA) with respect to any Plan (or the Internal Revenue Service gives notice to the PBGC of any "reportable event" as defined in subsection (c)(2) of Section 4043 of ERISA and Borrower obtains knowledge thereof) which might constitute grounds for a termination of such Plan under Title IV of ERISA, or knows that the plan administrator of any Plan has given or is required to give notice of any such reportable event, a copy of the notice of such reportable event given or required to be given to the PBGC; and (e) the occurrence of any Potential Event of Default or Event of Default.

5.11 Additional Payments; Additional Acts. From time to time, Borrower will (a) pay or reimburse Agent and Lenders on request for all reasonable expenses, including legal fees, actually incurred by Agent or Lenders in connection with the preparation of the Loan Documents or the making of any Loan or the administration of the transactions described in the Loan Documents or the enforcement by judicial proceedings or otherwise of any of the rights of Lenders under the Loan Documents; (b) obtain and promptly furnish to Agent evidence of all such Government Approvals as may be required to enable Borrower to comply with its obligations under the Loan Documents; and (c) execute and deliver all such instruments and perform all such other acts as Agent may reasonably request to carry out the transactions contemplated by this Agreement.

5.12 Working Capital. If there are Loans then outstanding, Borrower and its consolidated Subsidiaries shall have, at the end of each calendar month, a ratio of current assets to current liabilities of at least 1.25 to 1. For purposes of this section, (a) current assets shall not include (i) any deferred assets other than prepaid items such as insurance,

taxes, or other similar items or those deferred against a current contract, or (ii) any accounts receivable, loans or other amounts due from corporations, joint ventures, partnerships and other entities which are Subsidiaries or otherwise affiliated with Borrower, other than accounts receivable generated from the sale of Borrower's products in arm's length transactions with such corporations, joint ventures, partnerships and other entities and occurring in the ordinary course of Borrower's business, and (b) current liabilities shall include all outstanding Loans, together with accrued but unpaid interest thereon but shall not include any portion of Subordinated Debt.

5.13 Total Liabilities to Tangible Capital Ratio. If there are Loans then outstanding, Borrower and its consolidated Subsidiaries shall have, at the end of each calendar month, a ratio of Total Liabilities to Tangible Capital of no more than 1.00 to 1, and a Tangible Capital of not less than \$90,000,000. "Total Liabilities" means all the liabilities of Borrower and its consolidated Subsidiaries as reported on the consolidated balance sheet of Borrower and such Subsidiaries under generally accepted accounting principles, plus guaranties permitted under Section 6.2 (but excluding performance bond obligations which are permitted under Section 6.2), minus Subordinated Debt. "Tangible Capital" means the difference between (a) the sum of (i) shareholders' equity in Borrower and its consolidated subsidiaries as of such date of determination (such figure to reflect a deduction for all loans and advances to Borrower's and its Subsidiaries' officers and employees for purchase of Borrower's and its Subsidiaries' stock, as applicable), plus (ii) to the extent not included in such shareholders' equity, Subordinated Debt and (b) the sum of (i) all assets which should be classified as intangible assets, such as goodwill, patents, trademarks, copyrights, franchises, unamortized debt discount, research and development costs and deferred charges (unless deferred against a current contract), (ii) capitalized software costs, and (iii) "other assets" as presently reported on Borrower's balance sheet as non-current assets, other than (i.e., excluding) long-term accounts receivable from utility customers under Outsourcing Contracts.

ARTICLE 6  
NEGATIVE COVENANTS OF BORROWER

So long as Lenders shall have any Commitment hereunder and until payment in full of each Loan and Note and performance of all other obligations of Borrower under the Loan Documents, Borrower agrees that none of the following shall be done, unless each Lender shall otherwise consent in writing.

6.1 Liquidation, Merger, Sale of Assets. Borrower shall not, and shall cause its Material Subsidiaries not to (a) liquidate or dissolve, (b) enter into any material merger or consolidation except that any Material subsidiary may merge or consolidate into any other Subsidiary or into Borrower, nor (c)

sell, lease, or dispose of such portion of their business or assets (excepting sales of goods in the ordinary course of business) as constitutes in the reasonable opinion of Agent a substantial portion thereof; provided, that, notwithstanding this provision, Borrower shall be permitted to sell its accounts receivable generated from Outsourcing Contracts.

6.2 Indebtedness, Guaranties, Etc. Borrower shall not, and shall cause its Subsidiaries not to, create, incur, assume, permit to exist, or otherwise become committed for any Indebtedness, nor assume, guaranty, endorse or otherwise become directly or contingently liable for, nor obligated to purchase, pay or provide funds for payment of, any obligation or Indebtedness of any other person, except by endorsement of negotiable instruments for deposit or collection or by similar transactions in the ordinary course of business. Notwithstanding the foregoing, Borrower and its Subsidiaries may incur long-term Indebtedness, Subordinated Debt, and nonrecourse indebtedness without limit; may obtain performance bonds in an unlimited amount to support its obligations and those of its Subsidiaries with regard to Outsourcing Contracts; and shall in addition be permitted to incur and guaranty outstanding Indebtedness not exceeding \$15,000,000 in the aggregate (excluding performance bond obligations), and Borrower and any Subsidiary may guaranty the Indebtedness of one another.

6.3 Liens. Borrower shall not, and shall cause its Material Subsidiaries not to, create, assume or suffer to exist any Lien except (i) Liens in favor of Agent, (ii) a Lien to Pentzer Development Company in the original principal amount of \$5,600,000 to finance acquisition of Borrower's corporate headquarters and manufacturing facility in Spokane, Washington, (iii) Liens on fixed assets used in carrying out Outsourcing Contracts, (iv) Liens on accounts receivable generated from Outsourcing Contracts, (v) Liens to secure Indebtedness for the deferred price of property, but only if they are limited to such property and its proceeds and do not exceed 80% of the fair market value thereof (or, in the case of purchase money financing for personal property, do not exceed 100% of the fair market value thereof), and (vi) other Liens securing obligations not exceeding \$3,000,000 in the aggregate.

6.4 Operations. Borrower shall not, and shall cause its Material Subsidiaries not, to engage in any activity which is substantially different from or unrelated to their present business activities nor discontinue any portion of their present business activities which constitutes a substantial portion thereof.

6.5 Permissible Loans. Borrower shall not make any loan or advance to any Person other than (a) advances made in the ordinary course of business; (b) loans to Subsidiaries, and to joint ventures of which Borrower is a partner, not exceeding \$15,000,000 in the aggregate; and (c) loans to Subsidiaries in any amount if such Subsidiary provides to Lender prior to the

disbursement of such loan a limited guaranty of the Obligations, in the form of Exhibit E hereto, limited in principal amount to the principal amount of such loan. Upon repayment to Borrower of any such Subsidiary loan, Lender shall, upon request by Borrower, release such guaranty.

6.6 Contracts. Borrower shall not, and shall cause its Material Subsidiaries not to, enter into any significant contracts or other agreements except in the usual course of its business.

6.7 Securities. Borrower shall not, and shall cause its Material Subsidiaries not to, issue, sell, or otherwise distribute any stock, bond, note, or debenture or other security of Borrower and its Subsidiaries except (i) common or preferred stock (or warrants or options therefor), (ii) notes or other debt instruments evidencing Indebtedness permitted by this Agreement, and (iii) securities of any Subsidiary that are issued to Borrower.

6.8 ERISA Compliance. Neither Borrower nor any Plan will:

(a) engage in any "prohibited transaction" (as such term is defined in Section 406 or Section 2003(a) of ERISA);

(b) incur any "accumulated funding deficiency" (as such term is defined in Section 302 of ERISA) whether or not waived;

(c) terminate any Pension Plan in a manner which could result in the imposition of a Lien on any property of Borrower or any member of the Controlled Group pursuant to Section 4068 of ERISA; or

(d) violate state or federal securities laws applicable to any Plan which may result in material liability to Borrower or any member of the Controlled Group.

6.9 Payments on Subordinated Debt; Prepayments of Indebtedness. Borrower will not make any payments on Subordinated Debt or prepayments of principal of any Indebtedness during any period when there are loans outstanding and a Potential Event of Default or an Event of Default has occurred and is continuing or would be caused by such act. Additionally, Borrower shall not at any time when there are Loans outstanding, repay any Subordinated Debt which, at the end of the preceding calendar quarter, was necessary to Borrower's compliance with Section 5.13.

ARTICLE 7  
EVENTS OF DEFAULT

7.1 Events of Default. The occurrence of any of the following events shall constitute an "Event of Default" hereunder:

(a) Payment Default. Borrower shall fail to pay, within five (5) calendar days of when due, any amount of principal of or interest on any Loan or Note or any commitment fees due hereunder or, within 30 days after notice from Agent, any other amount payable to Agent or Lenders hereunder; or

(b) Breach of Warranty. Any representation or warranty made by Borrower in any Loan Document shall prove to have been incorrect in any material respect when made and shall prove to be material in any respect when discovered; or

(c) Breach of Certain Covenants. Any provision of Sections 5.2 or 6.1 shall not have been complied with; or

(d) Breach of Other Covenants. Any other covenant or obligation of Borrower in any Loan Document, except Section 5.7 of this Agreement to the extent Section 5.7 relates to delinquent Indebtedness, shall not have been complied with and such failure shall remain unremedied for 30 days after written notice thereof shall have been given to Borrower by Agent; provided that Lenders shall not unreasonably or arbitrarily withhold consent to an extension of such period if corrective action is initiated within such period and is being diligently pursued by Borrower; or

(e) Cross-default. Borrower or any Subsidiary shall fail in respect of Indebtedness having an aggregate outstanding balance of \$500,000 (i) to pay when due (whether by scheduled maturity, required prepayment, acceleration, demand or otherwise) any such Indebtedness (except any Loan) or any interest or premium thereon and such failure shall continue after the applicable grace period, if any, specified in the agreement or instrument relating to such Indebtedness, or (ii) to perform any term or covenant on its part to be performed under any agreement or instrument relating to any such Indebtedness and required to be performed and such failure shall continue after the applicable grace period, if any, specified in such agreement or instrument, if the effect of such failure to perform is to accelerate or to permit the acceleration of the maturity of such Indebtedness, or (iii) any such Indebtedness shall be declared to be due and payable or required to be prepaid (other than by regularly scheduled required prepayment) prior to the stated maturity thereof; or

(f) Voluntary Bankruptcy, Etc. Borrower or any Subsidiary shall: (1) file a petition seeking relief for itself under Title 11 of the United States Code, as now constituted or hereafter amended, or file an answer consenting to, admitting the

material allegations of or otherwise not controverting, or fail timely to controvert a petition filed against it seeking relief under Title 11 of the United States Code, as now constituted or hereafter amended; or (2) file such petition or answer with respect to relief under the provisions of any other now existing or future applicable bankruptcy, insolvency, or other similar law of the United States of America or any State thereof or of any other country or jurisdiction providing for the reorganization, winding-up or liquidation of corporations or an arrangement, composition, extension or adjustment with creditors; or

(g) Involuntary Bankruptcy, Etc. An order for relief shall be entered against Borrower or any Subsidiary under Title 11 of the United States Code, as now constituted or hereafter amended, which order is not stayed within 90 days; or upon the entry of an order, judgment or decree by operation of law or by a court having jurisdiction in the premises which is not stayed adjudging it a bankrupt or insolvent under, or ordering relief against it under, or approving as properly filed a petition seeking relief against it under the provisions of any other now existing or future applicable bankruptcy, insolvency or other similar law of the United States of America or any State thereof or of any other country or jurisdiction providing for the reorganization, winding-up or liquidation of corporations or any arrangement, composition, extension or adjustment with creditors,, or appointing a receiver, liquidator, assignee, sequestrator, trustee or custodian of Borrower or any Subsidiary or of any substantial part of its property, or ordering the reorganization, winding-up or liquidation of its affairs, or upon the expiration of 120 days after the filing of any involuntary petition against it seeking any of the relief specified in Section 7.1(f) or this Section 7.1(g) without the petition being dismissed prior to that time; or

(h) Insolvency, Etc. Borrower or any Subsidiary shall (i) make a general assignment for the benefit of its creditors or (ii) consent to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, or custodian of all or a substantial part of the property of Borrower or any Subsidiary, or (iii) admit its insolvency or inability to pay its debts generally as they become due, or (iv) fail generally to pay its debts as they become due, or (v) take any action (or suffer any action to be taken by its directors or shareholders) looking to the dissolution or liquidation of Borrower or any Subsidiary; or

(i) Judgment. A final judgment or order for the payment of money in excess of \$250,000 shall be rendered against Borrower or any Subsidiary and such judgment or order shall continue unsatisfied and in effect for a period of 90 consecutive days without having been appealed and stayed; or

(j) Condemnation. Such portion of the property of Borrower or any Subsidiary as in the opinion of Agent constitutes a substantial portion shall be condemned, seized or appropriated,

and such condemnation, seizure or appropriation shall be likely to have a material adverse effect on the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole; or

(k) Other Government Action. Any act of any Governmental Authority shall (in the opinion of Agent) deprive Borrower or any Subsidiary of any right, privilege or franchise, or restrict the exercise thereof, the deprivation or restriction of which shall have a material adverse effect on the business, operations or financial condition of the enterprise comprised of Borrower and its Subsidiaries taken as a whole, and such act shall not be revoked or rescinded within sixty (60) days after it shall have become effective or within thirty (30) days after notice from Agent, whichever first occurs; or

(l) ERISA. Borrower or any member of the Controlled Group shall fail to pay when due an amount or amounts aggregating in excess of \$500,000 which it shall have become liable to pay to the PBGC or to a Plan under Section 515 of ERISA or Title IV of ERISA; or notice of intent to terminate a Plan or Plans (other than a multi-employer plan, as defined in Section 4001(3) of ERISA), having aggregate unfunded vested liabilities in excess of \$500,000 shall be filed under Title IV of ERISA by Borrower, any member of the Controlled Group, any plan administrator or any combination of the foregoing; or the PBGC shall institute proceedings under Title IV of ERISA to terminate any such Plan or Plans.

7.2 Consequences of Default. If any Event of Default shall occur and be continuing, then in any such case and at any time thereafter so long as any such Event of Default shall be continuing, Agent will at the request of both Lenders immediately terminate the Commitments and, if any Loan shall have been made, Agent will at the request of both Lenders declare the principal of and the interest on any Loan and any Note and all other sums payable by Borrower hereunder or thereunder to be immediately due and payable, whereupon the same shall become immediately due and payable without protest, presentment, notice or demand, all of which Borrower expressly waives.

#### ARTICLE 8 AGENT

8.1 Authorization and Action. Each Lender hereby appoints and authorizes Agent to take such action as agent on its behalf and to exercise such powers under this Agreement and the other Loan Documents as are delegated to Agent by the terms hereof, together with such powers as are reasonably incidental thereto. As to any matters not expressly provided for in this Agreement, including enforcement or collection of the Notes, Agent shall not be required to exercise any discretion or take any action, but shall be required to act or to refrain from acting (and shall be fully protected in so acting or refraining)

upon the instructions of both Lenders, except that Agent shall not be required to take any action which exposes Agent to personal liability or which is contrary to this Agreement or applicable law. Each Lender and holder of a Note shall execute and deliver such additional instruments, including powers of attorney in favor of Agent, as may be required by applicable law to enable Agent to exercise its powers hereunder.

#### 8.2 Duties and Obligations.

(a) Neither Agent nor any of its directors, officers, agents or employees shall be liable for any action taken or omitted to be taken by it or any of them under or in connection with this Agreement except for its or their own gross negligence or willful misconduct. Without limiting the generality of the foregoing, Agent (i) may treat the payee of any Note as the holder thereof until Agent receives written notice of the assignment thereof signed by such payee and a written agreement of the assignee that it is bound hereby as it would have been had it been an original party hereto, in each case in form satisfactory to Agent; (ii) may consult with legal counsel (including counsel for Borrower), independent public accountants and other experts selected by it and shall not be liable for any action taken or omitted to be taken in good faith by it in accordance with the advice of such experts; (iii) makes no warranty or representation to any Lender and shall not be responsible to any Lender for any statements, warranties or representations made in or in connection with this Agreement or in any instrument or document furnished pursuant hereto; (iv) shall not have any duty to ascertain or to inquire as to the performance of any of the terms, covenants, or conditions of this Agreement on the part of Borrower or as to the use of the proceeds of any Loan or, unless the officers of Agent active in their capacity as officers of Agent on Borrower's account have actual knowledge thereof or have been notified in writing thereof by a Lender, the existence or possible existence of any Potential Event of Default or any Event of Default; (v) shall not be responsible to any Lender for the due execution, legality, validity, enforceability, genuineness, effectiveness, or value of this Agreement or of any instrument or document furnished pursuant hereto; and (vi) shall incur no liability under or in respect to this Agreement by acting upon any notice, consent, certificate or other instrument or writing (which may be by telegram, telecopy, cable or telex) believed by it to be genuine and signed or sent by the proper party or parties or by acting upon any representation or warranty of Borrower deemed to be made hereunder;

(b) Agent will account to each Lender for its Pro Rata Share of payments of principal, interest and commitment fees received by Agent from Borrower and will remit to Lenders entitled thereto all of the payments received hereunder from Borrower for the account of Lenders. Agent will transmit to each Lender copies of documents received from Borrower or others pursuant to the requirements of this Agreement.

8.3 Dealings Between Agent and Borrower. With respect to its Commitment, the Loan made by it, and the Note issued to it, Agent shall have the same rights and powers under this Agreement as any other Lender and may exercise the same as though it were not Agent, and the term "Lender" shall unless otherwise expressly indicated include Agent in its individual capacity. Agent may accept deposits from, lend money to, act and generally engage in any kind of business with Borrower and any person which may do business with Borrower, all as if Agent were not Agent hereunder and without any duty to account therefor to Lenders.

8.4 Lender Credit Decision. Each Lender acknowledges that it has, independently and without reliance upon Agent or any other Lender and based upon such documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement. Each Lender also acknowledges that it will, independently and without reliance upon Agent or any other Lender and based upon such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under this Agreement.

8.5 Indemnification. Lenders agree to indemnify Agent (to the extent not reimbursed by Borrower) ratably according to their respective Commitments from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements of any kind or nature whatsoever which may be imposed on, incurred by or asserted against Agent in any way relating to or arising out of this Agreement or any action taken or omitted by Agent under this Agreement, except any such as result from Agent's gross negligence or willful misconduct. Without limiting the foregoing, each Lender agrees to reimburse Agent promptly on demand for its ratable share of any out-of-pocket expenses, including legal fees, incurred by Agent in connection with the administration or enforcement of or the preservation of any rights under this Agreement (to the extent that Agent is not reimbursed for such expenses by Borrower).

8.6 Successor Agent. Agent may resign at any time by giving written notice thereof to Lenders and Borrower and may be removed at any time with or without cause by both Lenders. Upon any such resignation or removal, Lenders shall have the right to appoint a successor Agent. If no successor Agent shall have been so appointed by Lenders and shall have accepted such appointment within thirty (30) days after the retiring Agents' giving of notice of resignation or Lenders' removal of the retiring Agent, then the retiring Agent may on behalf of Lenders, appoint a successor Agent, which shall be a bank organized under the laws of the United States or of any state thereof, or any affiliate of such bank, and having a combined capital and surplus of at least Twenty-Five Million Dollars (\$25,000,000). Upon the acceptance of any appointment as Agent hereunder by a successor Agent, such successor Agent shall thereupon succeed to and become vested with all the rights, powers, privileges and duties of the retiring

Agent, and the retiring Agent shall be discharged from its duties and obligations under this Agreement. After any retiring Agent's resignation or removal hereunder as Agent, the provisions of this Article 8 shall inure to its benefit as to any actions taken or omitted to be taken by it while it was Agent under this Agreement.

ARTICLE 9  
MISCELLANEOUS

9.1 No Waiver; Remedies Cumulative. No failure by Agent or any Lender to exercise, and no delay in exercising, any right, power or remedy under this Agreement or any Loan Document shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power or remedy under any Loan Document preclude any other or further exercise thereof or the exercise of any other right, power, or remedy. The exercise of any right, power, or remedy shall in no event constitute a cure or waiver of any Event of Default nor prejudice the right of Agent or any Lender in the exercise of any right hereunder or thereunder, unless in the exercise of such right, all obligations of Borrower under the Loan Documents are paid in full. The rights and remedies provided herein and therein are cumulative and not exclusive of any right or remedy provided by law.

9.2 Governing Law. This Agreement and any Note shall be governed by and construed in accordance with the laws of the State of Washington, U.S.A.

9.3 Consent to Jurisdiction; Waiver of Immunities. Borrower hereby irrevocably submits to the jurisdiction of any state or federal court sitting in Spokane, Spokane County, Washington, in any action or proceeding brought to enforce or otherwise arising out of or relating any to Loan Document. Nothing herein shall impair the right of Agent or any Lender to bring any action or proceeding against Borrower or its property in the courts of any other jurisdiction.

9.4 Notices. All notices and other communications provided for in this Agreement shall be in writing or (unless otherwise specified) by telex, telecopy or telegram and shall be mailed or sent or delivered to each party at the address set forth under its name on the signature page hereof, or at such other address as shall be designated by such party in a written notice to each other party. Except as otherwise specified, all such notices and communications if duly given or made shall be effective upon receipt.

9.5 Assignment. This Agreement shall be binding upon and inure to the benefit of the parties and their respective Successors and assigns, except that Borrower may not assign or otherwise transfer all or any part of its rights or obligations hereunder without the prior written consent of Lenders, and any

such assignment or transfer purported to be made without such consent shall be ineffective.

9.6 Severability. Any provision of this Agreement or any Note which is prohibited or unenforceable in any jurisdiction shall as to such jurisdiction be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof or affecting the validity or enforceability of such provision in any other jurisdiction. To the extent permitted by applicable law, the parties waive any provision of law which renders any provision hereof prohibited or unenforceable in any respect.

9.7 Conditions Not Fulfilled. If the Commitment or any portion thereof is not borrowed owing to nonfulfillment of any condition precedent specified in Article 3, neither Borrower nor either Lender shall be responsible to the others for any damage or loss by reason thereof, except that Borrower shall in any event be liable to pay the fees, taxes, and expenses for which it is obligated hereunder.

9.8 Entire Agreement; Amendment. This Agreement comprises the entire agreement of the parties and may not be amended or modified except by written agreement of Borrower, Agent and both Lenders. No provision of this Agreement may be waived except in writing and then only in the specific instance and for the specific purpose for which given.

9.9 Conflicting Agreements. In the event of any conflict between the terms of this Agreement and the terms of any Note, the terms of this Agreement shall govern.

9.10 Oral Agreements. Borrower is hereby given the following notice:

ORAL AGREEMENTS OR ORAL COMMITMENTS TO LOAN MONEY, EXTEND CREDIT OR TO FORBEAR FROM ENFORCING REPAYMENT OF A DEBT ARE NOT ENFORCEABLE UNDER WASHINGTON LAW.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective officers or agents thereunto duly authorized to be effective as of the date first above written.

BORROWER: ITRON, INC.

By \_\_\_\_\_

Title \_\_\_\_\_

Address:  
2818 N. Sullivan Road  
Spokane, WA 99216  
Attn: Treasurer

LENDERS: BANK OF AMERICA NW, N.A.

By \_\_\_\_\_

Title \_\_\_\_\_

Address:  
Northwest National Division  
701 Fifth Avenue, 12th Floor  
Seattle, WA 98104  
Attn: David A. Dehlendorf

LENDERS: WASHINGTON TRUST BANK

By \_\_\_\_\_

Title \_\_\_\_\_

Address:  
West 717 Sprague  
Spokane, WA 99204  
Attn: David Hayward

BANK OF AMERICA NW, N.A.

By \_\_\_\_\_

Title \_\_\_\_\_

Address:

Seafirst Agency Services  
701 Fifth Avenue, 16th Floor  
Seattle, WA 98104  
Attn: Dora Brown

EXHIBIT A

FORM OF NOTICE OF BORROWING

Pursuant to that certain Loan Agreement dated as of July 1, 1996, (the "Loan Agreement") among Itron, Inc., as Borrower, Bank of America NW, N.A. and Washington Trust Bank as Lenders, and Bank of America NW, N.A. as Agent, Borrower requests to borrow on \_\_\_\_\_ from Lenders on a pro rata basis \$ \_\_\_\_\_ as [Prime Rate] [CD] or [LIBOR] Loans. [The Applicable Interest Period for such Loans is requested to be a \_\_\_\_\_ period.]\*

Borrower certifies that:

(i) the representations and warranties of Borrower contained in the Loan Agreement are true, correct and complete in all material respects on and as of the date hereof to the same extent as though made on and as of the date hereof;

(ii) no Event of Default or Potential Event of Default has occurred and is continuing under the Loan Agreement or will result from the proposed borrowing; and

(iii) at the end of the last calendar quarter preceding the Loan requested herein, Borrower was in compliance with Sections 5.12 and 5.13 of the Loan Agreement (applying such covenants as if the Loans being requested were outstanding as of the end of such calendar quarter) and, since the end of such calendar quarter, Borrower has not redeemed any equity or repaid any Subordinated Debt which, if it had occurred immediately prior to the end of the calendar quarter, would have resulted in a violation of Sections 5.12 or 5.13 (if there had then been Loans outstanding).

DATED as of \_\_\_\_\_.

ITRON, INC.

By \_\_\_\_\_

Title \_\_\_\_\_

\* Complete this sentence if the Loan is a CD Loan or a LIBOR Loan

EXHIBIT B

FORM OF NOTICE OF REFINANCING

Pursuant to that certain Loan Agreement dated as of July 1, 1996, (the "Loan Agreement") among Itron, Inc., as Borrower, Bank of America NW, N.A. and Washington Trust Bank as Lenders, and Bank of America NW, N.A. as Agent, this represents Borrower's request to [complete either (a) or (b)]:

(a) convert \$ \_\_\_\_\_ in principal amount of Loans to \_\_\_\_\_ Loans on \_\_\_\_\_, 19\_\_\_\_; or

(b) continue as \_\_\_\_\_ Loans \$ \_\_\_\_\_ in principal amount of presently outstanding \_\_\_\_\_ Loans with an Applicable Interest Period ending on \_\_\_\_\_, 19\_\_\_\_.

The Applicable Interest Period for such converted or continued Loans is requested to be a \_\_\_\_\_ period.]\*

Borrower certifies that:

(i) the representations and warranties of Borrower contained in the Loan Agreement are true, correct and complete in all material respects on and as of the date hereof to the same extent as though made on and as of the date hereof;

(ii) no Event of Default or Potential Event of Default has occurred and is continuing under the Loan Agreement or will result from the proposed borrowing; and

(iii) at the end of the last calendar quarter preceding the conversion or continuation requested herein, Borrower was in compliance with Sections 5.12 and 5.13 of the Loan Agreement (applying such covenants as if the Loans being requested were outstanding as of the end of such calendar quarter) and, since the end of such calendar quarter, Borrower has not redeemed any equity or repaid any Subordinated Debt which, if it had occurred immediately prior to the end of the calendar quarter, would have resulted in a violation of Sections 5.12 or 5.13 (if there had then been Loans outstanding).

DATED as of \_\_\_\_\_.

ITRON, INC.

By \_\_\_\_\_

Title \_\_\_\_\_

\* Complete this sentence if the converted or continued Loan is to be a CD Loan or a LIBOR Loan.

## EXHIBIT C

## FORM OF REVOLVING NOTE

\$ \_\_\_\_\_

Date: July 1, 1996  
Seattle, Washington

This REVOLVING NOTE ("Note") is made pursuant to and is subject to the terms and conditions of that certain Loan Agreement dated as of July 1, 1996, (the "Loan Agreement") among Itron, Inc., as Borrower, Bank of America NW, N.A. and Washington Trust Bank as Lenders, and Bank of America NW, N.A. as Agent, for Lenders. Terms used herein that are not otherwise defined shall have the respective meanings set forth in the Loan Agreement.

FOR VALUE RECEIVED, Borrower promises to pay to the order of \_\_\_\_\_ ("Lender") the principal amount of each Loan made by Lender to Borrower as part of such Lender's Commitment (each such loan or advance being hereinafter individually referred to as a "Lender Loan" and collectively as the "Lender Loans") on the date and in the manner set forth in the Loan Agreement.

Borrower also hereby promises to pay to the order of Lender interest on the unpaid principal amount of each Lender Loan from the date of such Loan until such principal amount is paid in full at such interest rates and at such times as are specified in the Loan Agreement.

1. This Note evidences a revolving line of credit to Borrower from Lender, and during the Commitment Period, Borrower may borrow money from Lender in an aggregate principal amount not to exceed the sum of \_\_\_\_\_ Dollars (\$ \_\_\_\_\_) subject to the terms and conditions of the Loan Agreement. This Note is given to avoid execution of an individual promissory note for each Lender Loan. Each Lender Loan (and each conversion or continuation thereof pursuant to Section 2.5 of the Loan Agreement), whether such Loan is a CD Loan, a Prime Rate Loan or a LIBOR Loan, and, in the case of a CD Loan or a LIBOR Loan, the Applicable Interest Period and all payments made on account of the principal of the Lender Loans shall be recorded by Lender in its records; the failure to so record any such amount or any error in so recording such amount shall not, however, limit or otherwise affect the obligations of Borrower to repay the outstanding principal amount of the Lender Loans together with all interest accruing thereon.

2. Each maker, surety, guarantor and endorser of this Note expressly waives all notices, demands for payment, presentations for payment, notices of intention to accelerate the maturity, protest and notice of protest as to this Note.

3. Borrower promises to pay all costs and expenses, including reasonable attorneys' fees, incurred in the collection and enforcement of this Note.

4. This Note shall be governed by, and shall be construed and enforced in accordance with the laws of the State of Washington.

5. This Note is one of the Notes described in the Loan Agreement to which reference is hereby made for a more complete statement of the terms and conditions under which the Lender Loans are made and are to be repaid. The Loan Agreement contains, among other things, provisions for acceleration of the maturity hereof upon the happening of certain stated events and also for the terms and conditions of principal prepayments prior to the maturity.

6. This Note is executed and delivered concurrently with the execution of the Loan Agreement and is one of the promissory notes described in Section 2.6 thereof.

ITRON, INC.

By \_\_\_\_\_

Title \_\_\_\_\_

## Exhibit 1 -- PREPAYMENT FEES

If the principal balance of this note is prepaid in whole or in part, whether by voluntary prepayment, operation of law, acceleration or otherwise, a prepayment fee, in addition to any interest earned, will be immediately payable to the holder of this note.

The amount of the prepayment fee depends on the following:

- (1) The amount by which interest reference rates as defined below have changed between the time the loan is prepaid and either a) the time the loan was made for fixed rate loans, or b) the time the interest rate last changed (repriced) for variable rate loans.
- (2) A prepayment fee factor (see "Prepayment Fee Factor Schedule" on reverse).
- (3) The amount of principal prepaid.

If the proceeds from a CD or time deposit pledged to secure the loan are used to prepay the loan resulting in payment of an early withdrawal penalty for the CD, a prepayment fee will not also be charged under the loan.

## DEFINITION OF PREPAYMENT REFERENCE RATE FOR VARIABLE RATE LOANS

The "Prepayment Reference Rate" used to represent interest rate levels for variable rate loans shall be the index rate used to determine the rate on this loan having maturities equivalent to the remaining period to interest rate change date (repricing) of this loan rounded upward to the nearest month. The "Initial Prepayment Reference Rate" shall be the Prepayment Reference Rate at the time of last repricing and a new Initial Prepayment Reference Rate shall be assigned at each subsequent repricing. The "Final Prepayment Reference Rate" shall be the Prepayment Reference Rate at the time of prepayment.

## DEFINITION OF PREPAYMENT REFERENCE RATE FOR FIXED RATE LOANS

The "Prepayment Reference Rate" used to represent interest rate levels on fixed rate loans shall be the bond equivalent yield of the average U.S. Treasury rate having maturities equivalent to the remaining period to maturity of this loan rounded upward to the nearest month. The "Initial Prepayment Reference Rate" shall be the Prepayment Reference Rate at the time the loan was made. The "Final Prepayment Reference Rate" shall be the Prepayment Reference Rate at time of prepayment.

The Prepayment Reference Rate shall be interpolated from the yields as displayed on Page 119 of the Dow Jones Telerate Service (or such other page or service as may replace that page or service for the purpose of displaying rates comparable to said U.S. Treasury rates) on the day the loan was made (Initial Prepayment Reference Rate) or the day of prepayment (Final Prepayment Reference Rate).

An Initial Prepayment Reference Rate of N/A % has been assigned to this loan to represent interest rate levels at origination.

## CALCULATION OF PREPAYMENT FEE

If the Initial Prepayment Reference Rate is less than or equal to the Final Prepayment Reference Rate, there is no prepayment fee.

If the Initial Prepayment Reference Rate is greater than the Final Prepayment Reference Rate, the prepayment fee shall be equal to the difference between the Initial and Final Prepayment Reference Rates (expressed as a decimal), multiplied by the appropriate factor from the Prepayment Fee Factor Schedule, multiplied by the principal amount of the loan being prepaid.

EXAMPLE OF PREPAYMENT FEE CALCULATION

VARIABLE RATE LOAN: A non-amortizing 6-month LIBOR based loan with principal of \$250,000 is fully prepaid with 3 months remaining until next interest rate change date (repricing). An Initial Prepayment Reference Rate of 7.0% was assigned to the loan at last repricing. The Final Prepayment Reference Rate (as determined by the 3-month LIBOR index) is 6.5%. Rates therefore have dropped 0.5% since last repricing and a prepayment fee applies. A prepayment fee factor of 0.31 is determined from Table 3 below and the prepayment fee is computed as follows:

$$\text{Prepayment Fee} = (0.07 - 0.065) \times (0.31) \times (\$250,000) = \$387.50$$

FIXED RATE LOAN: An amortizing loan with remaining principal of \$250,000 is fully prepaid with 24 months remaining until maturity. An Initial Prepayment Reference Rate of 9.0% was assigned to the loan when the loan was made. The Final Prepayment Reference Rate (as determined by the current 24-month U.S. Treasury rate on Page 119 of Telerate) is 7.5%. Rates therefore have dropped 1.5% since the loan was made and a prepayment fee applies. A prepayment fee factor of 1.3 is determined from Table 1 below and the prepayment fee is computed as follows:

$$\text{Prepayment Fee} = (0.09 - 0.075) \times (1.3) \times (\$250,000) = \$4,875$$

PREPAYMENT FEE FACTOR SCHEDULE

TABLE I: FULLY AMORTIZING LOANS

Proportion of Remaining Principal Amount Being Prepaid	Months Remaining To Maturity/Repricing(1)												
	0	3	6	9	12	24	36	48	60	84	120	240	360
90-100%	0	.21	.36	.52	.67	1.3	1.9	2.5	3.1	4.3	5.9	10.3	13.1
60-89%	0	.24	.44	.63	.83	1.6	2.4	3.1	3.9	5.4	7.5	13.2	17.0
30-59%	0	.28	.53	.78	1.02	2.0	3.0	4.0	5.0	7.0	9.9	18.5	24.4
0-29%	0	.31	.63	.92	1.22	2.4	3.7	5.0	6.3	9.0	13.4	28.3	41.8

TABLE II: PARTIALLY AMORTIZING (BALLOON) LOANS

Proportion of Remaining Principal Amount Being Prepaid	Months Remaining To Maturity/Repricing(1)												
	0	3	6	9	12	24	36	48	60	84	120	240	360
90-100%	0	.26	.49	.71	.94	1.8	2.7	3.4	4.2	5.6	7.4	11.6	14.0
60-89%	0	.30	.59	.86	1.15	2.2	3.3	4.3	5.3	7.1	9.4	15.0	18.1
30-59%	0	.31	.63	.95	1.27	2.6	3.9	5.3	6.6	9.1	12.6	21.2	26.2
0-29%	0	.31	.63	.95	1.27	2.6	4.0	5.4	7.0	10.2	15.7	33.4	46.0

TABLE III: NONAMORTIZING (INTEREST ONLY) LOANS

Proportion of Remaining Principal Amount Being Prepaid	Months Remaining To Maturity/Repricing(1)												
	0	3	6	9	12	24	36	48	60	84	120	240	360
0-100%	0	.31	.61	.91	1.21	2.3	3.4	4.4	5.3	6.9	8.9	13.0	14.8

(1) For the remaining period to maturity/repricing between any two maturities/repricings shown in the above schedules, interpolate between the corresponding factors to the closest month.

The holder of this note is not required to actually reinvest the prepaid principal in any U.S. Government Treasury Obligations, or otherwise prove its actual loss, as a condition to receiving a prepayment fee as calculated above.

## FIRST AMENDMENT TO LOAN AGREEMENT

This Amendment amends that certain Loan Agreement dated July 1, 1996 ("Agreement"), among Itron, Inc., as "Borrower," Bank of America NW, N.A., doing business as Seafirst Bank, and Washington Trust Bank as "Lenders," and Bank of America NW, N.A., doing business as Seafirst Bank, as "Agent." All terms defined in the Agreement shall have the same meaning when used in this Amendment, except as may be otherwise provided in this Amendment. Bank of America NW, N.A. has since merged into Bank of America National Trust and Savings Association, but continues to do business in the state of Washington as "Seafirst Bank." References to "Seafirst" or "Bank of America NW, N.A." in this Amendment and in the Agreement shall mean Bank of America National Trust and Savings Association, doing business as Seafirst Bank. For mutual consideration, the parties agree as follows:

1. Lenders. The initial paragraph of the Agreement and the definition of "Lenders" in Section 1.1 of the Agreement are both amended to provide that "Lenders" shall be Seafirst, Washington Trust Bank, U.S. Bank of Washington, National Association, and The Bank of Nova Scotia. References in the Agreement to "both Lenders" shall be deemed references to "all Lenders."

2. Definitions. Section 1.1 of the Agreement is amended to change the definition of "Pro Rata Share" to read as follows: "'Pro Rata Share' means 57-1/3% as to Seafirst, 9-1/3% as to Washington Trust Bank, 16-2/3% as to U.S. Bank of Washington, National Association, and 16-2/3% as to The Bank of Nova Scotia."

3. Prime Rate. Paragraph (A) of the definition of "Prime Rate" in Section 1.1 of the Agreement is amended to read as follows:

"the rate of interest publicly announced from time to time by Agent in San Francisco, California, as its "Reference Rate." The Reference Rate is set based on various factors, including Agent's costs and desired return, general economic conditions, and other factors, and is used as a reference point for pricing some loans. Agent may price loans to its customers at, above, or below the Reference Rate. Any change in the Reference Rate shall take effect at the opening of business on the day specified in the public announcement of a change in the Reference Rate; or"

4. Available Commitment. Section 2.1 of the Agreement is amended to change the amount "\$50,000,000" in the bottom row of column two of the table set forth therein to "\$75,000,000."

5. Working Capital. The first sentence of Section 5.12 of the Agreement is amended to read as follows: "If there are Loans then outstanding, Borrower and its consolidated Subsidiaries shall have, at the end of each fiscal quarter, a ratio of current assets to current liabilities of at least 1.25 to 1."

6. Capital Ratio. The first sentence of Section 5.13 of the Agreement is amended to read as follows: "If there are Loans then outstanding, Borrower and its consolidated Subsidiaries shall have, at the end of each fiscal quarter, a ratio of Total Liabilities to Tangible Capital of no more than 1.00 to 1, and a Tangible Capital of not less than \$90,000,000."

7. Exhibits. The forms of Exhibits A, B, and C to the Agreement shall be as shown in Exhibits A, B, and C, respectively, attached to this Amendment.

8. Addition of Lenders. Upon execution of this Amendment, Borrower shall pay a fee of \$12,500 each to U.S. Bank of Washington, National Association, and The Bank of Nova Scotia (the "New Lenders"); and the New Lenders shall each fund to Agent their respective Pro Rata Share of all outstanding Loans (with Agent to redistribute such funds to Lenders such that each Lender shall have

funded its Pro Rata Share of all outstanding Loans). All outstanding LIBOR Loans shall be deemed to have been prepaid on such date, and new LIBOR Loans funded, with Applicable Interest Periods to be designated by Borrower to Agent in writing. Lenders waive all prepayment fees with regard to the prepayment described in this paragraph only.

9. Notices. Section 9.4 of the Agreement is amended to provide that the address for each Lender shall be as set forth on the signature page of the Agreement or of any amendment thereto.

10. Other Terms. Except as specifically amended by this Amendment, all other terms, conditions, and definitions of the Agreement shall remain in full force and effect.

DATED as of January 15, 1997.

BORROWER: ITRON, INC. AGENT: SEAFIRST BANK

By \_\_\_\_\_ Title \_\_\_\_\_ By \_\_\_\_\_ Title \_\_\_\_\_

LENDERS: SEAFIRST BANK WASHINGTON TRUST BANK

By \_\_\_\_\_ Title \_\_\_\_\_ By \_\_\_\_\_ Title \_\_\_\_\_

U.S. BANK OF WASHINGTON, NATIONAL ASSOCIATION THE BANK OF NOVA SCOTIA

By \_\_\_\_\_ Title \_\_\_\_\_ By \_\_\_\_\_ Title \_\_\_\_\_

Address for Notices: 1420 Fifth Avenue, Floor 11 Seattle, Washington 98101 Attention: Cathy Schalkle Address for Notices: 888 S.W. Fifth Ave., Suite 750 Portland, Oregon 97204 Attention: Sharon Bishop

EXHIBIT A

FORM OF NOTICE OF BORROWING

Pursuant to that certain Loan Agreement dated as of July 1, 1996 (the "Loan Agreement"), among Itron, Inc., as Borrower, Seafirst Bank, Washington Trust Bank, U.S. Bank of Washington, National Association, and The Bank of Nova Scotia as Lenders, and Seafirst Bank as Agent, Borrower requests to borrow on \_\_\_\_\_ from Lenders on a pro rata basis \$ \_\_\_\_\_ as [Prime Rate] [CD] or [LIBOR] Loans. [The Applicable Interest Period for such Loans is requested to be a \_\_\_\_\_ period.]\*

Borrower certifies that:

(i) the representations and warranties of Borrower contained in the Loan Agreement are true, correct, and complete in all material respects on and as of the date hereof to the same extent as though made on and as of the date hereof;

(ii) no Event of Default or Potential Event of Default has occurred and is continuing under the Loan Agreement or will result from the proposed borrowing; and

(iii) at the end of the last calendar quarter preceding the Loan requested herein, Borrower was in compliance with Sections 5.12 and 5.13 of the Loan Agreement (applying such covenants as if the Loans being requested were outstanding as of the end of such calendar quarter) and, since the end of such calendar quarter, Borrower has not redeemed any equity or repaid any Subordinated Debt which, if it had occurred immediately prior to the end of the calendar quarter, would have resulted in a violation of Sections 5.12 or 5.13 (if there had then been Loans outstanding).

DATED as of \_\_\_\_\_.

ITRON, INC.

By \_\_\_\_\_

Title \_\_\_\_\_

\* Complete this sentence if the Loan is a CD Loan or a LIBOR Loan

EXHIBIT B

FORM OF NOTICE OF REFINANCING

Pursuant to that certain Loan Agreement dated as of July 1, 1996 (the "Loan Agreement"), among Itron, Inc., as Borrower, Seafirst Bank, Washington Trust Bank, U.S. Bank of Washington, National Association, and The Bank of Nova Scotia as Lenders, and Seafirst Bank as Agent, this represents Borrower's request to [complete either (a) or (b)]:

(a) convert \$ \_\_\_\_\_ in principal amount of Loans to \_\_\_\_\_ Loans on \_\_\_\_\_, 19\_\_\_\_; or

(b) continue as \_\_\_\_\_ Loans \$ \_\_\_\_\_ in principal amount of presently outstanding \_\_\_\_\_ Loans with an Applicable Interest Period ending on \_\_\_\_\_, 19\_\_\_\_.

The Applicable Interest Period for such converted or continued Loans is requested to be a \_\_\_\_\_ period.]\*

Borrower certifies that:

(i) the representations and warranties of Borrower contained in the Loan Agreement are true, correct and complete in all material respects on and as of the date hereof to the same extent as though made on and as of the date hereof;

(ii) no Event of Default or Potential Event of Default has occurred and is continuing under the Loan Agreement or will result from the proposed borrowing; and

(iii) at the end of the last calendar quarter preceding the conversion or continuation requested herein, Borrower was in compliance with Sections 5.12 and 5.13 of the Loan Agreement (applying such covenants as if the Loans being requested were outstanding as of the end of such calendar quarter) and, since the end of such calendar quarter, Borrower has not redeemed any equity or repaid any Subordinated Debt which, if it had occurred immediately prior to the end of the calendar quarter, would have resulted in a violation of Sections 5.12 or 5.13 (if there had then been Loans outstanding).

DATED as of \_\_\_\_\_.

ITRON, INC.

By \_\_\_\_\_

Title \_\_\_\_\_

\* Complete this sentence if the converted or continued Loan is to be a CD Loan or a LIBOR Loan.

## EXHIBIT C

## FORM OF REVOLVING NOTE

\$ \_\_\_\_\_

Date: January 15, 1997  
Seattle, Washington

This REVOLVING NOTE ("Note") is made pursuant to and is subject to the terms and conditions of that certain Loan Agreement dated as of July 1, 1996, as subsequently amended (the "Loan Agreement"), among Itron, Inc., as Borrower, Seafirst Bank, Washington Trust Bank, U.S. Bank of Washington, National Association, and The Bank of Nova Scotia as Lenders, and Seafirst Bank as Agent, for Lenders. Terms used herein that are not otherwise defined shall have the respective meanings set forth in the Loan Agreement.

FOR VALUE RECEIVED, Borrower promises to pay to the order of

\_\_\_\_\_ ("Lender") the principal amount of each Loan made by Lender to Borrower as part of such Lender's Commitment (each such loan or advance being hereinafter individually referred to as a "Lender Loan" and collectively as the "Lender Loans") on the date and in the manner set forth in the Loan Agreement.

Borrower also hereby promises to pay to the order of Lender interest on the unpaid principal amount of each Lender Loan from the date of such Loan until such principal amount is paid in full at such interest rates and at such times as are specified in the Loan Agreement.

1. This Note evidences a revolving line of credit to Borrower from Lender, and during the Commitment Period, Borrower may borrow money from Lender in an aggregate principal amount not to exceed the sum of \_\_\_\_\_ Dollars (\$ \_\_\_\_\_) subject to the terms and conditions of the Loan Agreement. This Note is given to avoid execution of an individual promissory note for each Lender Loan. Each Lender Loan (and each conversion or continuation thereof pursuant to Section 2.5 of the Loan Agreement), whether such Loan is a CD Loan, a Prime Rate Loan or a LIBOR Loan, and, in the case of a CD Loan or a LIBOR Loan, the Applicable Interest Period and all payments made on account of the principal of the Lender Loans shall be recorded by Lender in its records; the failure to so record any such amount or any error in so recording such amount shall not, however, limit or otherwise affect the obligations of Borrower to repay the outstanding principal amount of the Lender Loans together with all interest accruing thereon.

2. Each maker, surety, guarantor and endorser of this Note expressly waives all notices, demands for payment, presentations for payment, notices of intention to accelerate the maturity, protest and notice of protest as to this Note.

3. Borrower promises to pay all costs and expenses, including reasonable attorneys' fees, incurred in the collection and enforcement of this Note.

4. This Note shall be governed by, and shall be construed and enforced in accordance with the laws of the State of Washington.

5. This Note is one of the Notes described in the Loan Agreement to which reference is hereby made for a more complete statement of the terms and conditions under which the Lender Loans are made and are to be repaid. The Loan Agreement contains, among other things, provisions for acceleration of the maturity hereof upon the happening of certain stated events and also for the terms and conditions of principal prepayments prior to the maturity.

6. This Note is executed and delivered concurrently with the execution of the Loan Agreement and is one of the promissory notes described in Section 2.6 thereof.

ITRON, INC.

By \_\_\_\_\_

Title \_\_\_\_\_

## Exhibit 1 -- PREPAYMENT FEES

If the principal balance of this note is prepaid in whole or in part, whether by voluntary prepayment, operation of law, acceleration or otherwise, a prepayment fee, in addition to any interest earned, will be immediately payable to the holder of this note.

The amount of the prepayment fee depends on the following:

- (1) The amount by which interest reference rates as defined below have changed between the time the loan is prepaid and either a) the time the loan was made for fixed rate loans, or b) the time the interest rate last changed (repriced) for variable rate loans.
- (2) A prepayment fee factor (see "Prepayment Fee Factor Schedule" on reverse).
- (3) The amount of principal prepaid.

If the proceeds from a CD or time deposit pledged to secure the loan are used to prepay the loan resulting in payment of an early withdrawal penalty for the CD, a prepayment fee will not also be charged under the loan.

## DEFINITION OF PREPAYMENT REFERENCE RATE FOR VARIABLE RATE LOANS

The "Prepayment Reference Rate" used to represent interest rate levels for variable rate loans shall be the index rate used to determine the rate on this loan having maturities equivalent to the remaining period to interest rate change date (repricing) of this loan rounded upward to the nearest month. The "Initial Prepayment Reference Rate" shall be the Prepayment Reference Rate at the time of last repricing and a new Initial Prepayment Reference Rate shall be assigned at each subsequent repricing. The "Final Prepayment Reference Rate" shall be the Prepayment Reference Rate at the time of prepayment.

## DEFINITION OF PREPAYMENT REFERENCE RATE FOR FIXED RATE LOANS

The "Prepayment Reference Rate" used to represent interest rate levels on fixed rate loans shall be the bond equivalent yield of the average U.S. Treasury rate having maturities equivalent to the remaining period to maturity of this loan rounded upward to the nearest month. The "Initial Prepayment Reference Rate" shall be the Prepayment Reference Rate at the time the loan was made. The "Final Prepayment Reference Rate" shall be the Prepayment Reference Rate at time of prepayment.

The Prepayment Reference Rate shall be interpolated from the yields as displayed on Page 119 of the Dow Jones Telerate Service (or such other page or service as may replace that page or service for the purpose of displaying rates comparable to said U.S. Treasury rates) on the day the loan was made (Initial Prepayment Reference Rate) or the day of prepayment (Final Prepayment Reference Rate).

An Initial Prepayment Reference Rate of N/A % has been assigned to this loan to represent interest rate levels at origination.

## CALCULATION OF PREPAYMENT FEE

If the Initial Prepayment Reference Rate is less than or equal to the Final Prepayment Reference Rate, there is no prepayment fee.

If the Initial Prepayment Reference Rate is greater than the Final Prepayment Reference Rate, the prepayment fee shall be equal to the difference between the Initial and Final Prepayment Reference Rates (expressed as a decimal), multiplied by the appropriate factor from the Prepayment Fee Factor Schedule, multiplied by the principal amount of the loan being prepaid.

EXAMPLE OF PREPAYMENT FEE CALCULATION

VARIABLE RATE LOAN: A non-amortizing 6-month LIBOR based loan with principal of \$250,000 is fully prepaid with 3 months remaining until next interest rate change date (repricing). An Initial Prepayment Reference Rate of 7.0% was assigned to the loan at last repricing. The Final Prepayment Reference Rate (as determined by the 3-month LIBOR index) is 6.5%. Rates therefore have dropped 0.5% since last repricing and a prepayment fee applies. A prepayment fee factor of 0.31 is determined from Table 3 below and the prepayment fee is computed as follows:

$$\text{Prepayment Fee} = (0.07 - 0.065) \times (0.31) \times (\$250,000) = \$387.50$$

FIXED RATE LOAN: An amortizing loan with remaining principal of \$250,000 is fully prepaid with 24 months remaining until maturity. An Initial Prepayment Reference Rate of 9.0% was assigned to the loan when the loan was made. The Final Prepayment Reference Rate (as determined by the current 24-month U.S. Treasury rate on Page 119 of Telerate) is 7.5%. Rates therefore have dropped 1.5% since the loan was made and a prepayment fee applies. A prepayment fee factor of 1.3 is determined from Table 1 below and the prepayment fee is computed as follows:

$$\text{Prepayment Fee} = (0.09 - 0.075) \times (1.3) \times (\$250,000) = \$4,875$$

PREPAYMENT FEE FACTOR SCHEDULE

TABLE I: FULLY AMORTIZING LOANS

Proportion of Remaining Principal Amount Being Prepaid	Months Remaining To Maturity/Repricing(1)												
	0	3	6	9	12	24	36	48	60	84	120	240	360
90-100%	0	.21	.36	.52	.67	1.3	1.9	2.5	3.1	4.3	5.9	10.3	13.1
60-89%	0	.24	.44	.63	.83	1.6	2.4	3.1	3.9	5.4	7.5	13.2	17.0
30-59%	0	.28	.53	.78	1.02	2.0	3.0	4.0	5.0	7.0	9.9	18.5	24.4
0-29%	0	.31	.63	.92	1.22	2.4	3.7	5.0	6.3	9.0	13.4	28.3	41.8

TABLE II: PARTIALLY AMORTIZING (BALLOON) LOANS

Proportion of Remaining Principal Amount Being Prepaid	Months Remaining To Maturity/Repricing(1)												
	0	3	6	9	12	24	36	48	60	84	120	240	360
90-100%	0	.26	.49	.71	.94	1.8	2.7	3.4	4.2	5.6	7.4	11.6	14.0
60-89%	0	.30	.59	.86	1.15	2.2	3.3	4.3	5.3	7.1	9.4	15.0	18.1
30-59%	0	.31	.63	.95	1.27	2.6	3.9	5.3	6.6	9.1	12.6	21.2	26.2
0-29%	0	.31	.63	.95	1.27	2.6	4.0	5.4	7.0	10.2	15.7	33.4	46.0

TABLE III: NONAMORTIZING (INTEREST ONLY) LOANS

Proportion of Remaining Principal Amount Being Prepaid	Months Remaining To Maturity/Repricing(1)												
	0	3	6	9	12	24	36	48	60	84	120	240	360
0-100%	0	.31	.61	.91	1.21	2.3	3.4	4.4	5.3	6.9	8.9	13.0	14.8

1 For the remaining period to maturity/repricing between any two maturities/repricings shown in the above schedules, interpolate between the corresponding factors to the closest month.

The holder of this note is not required to actually reinvest the prepaid principal in any U.S. Government Treasury Obligations, or otherwise prove its actual loss, as a condition to receiving a prepayment fee as calculated above.

ITRON, INC.  
 COMPUTATION OF EARNINGS PER SHARE  
 (IN THOUSANDS)

## EXHIBIT 11

	Year ended December 31,		
	1994	1995	1996 (1)
Weighted average number of common shares outstanding	11,959	13,094	13,297
Dilutive effect of outstanding common stock options and warrants at average market price	892	681	0
Weighted average shares outstanding based on average market price	12,851	13,775	13,297
Primary EPS based on average market price	\$ 0.80	\$ 0.81	(\$ 0.11)

	1994	1995
Weighted average number of common shares outstanding	11,959	13,094
Dilutive effect of outstanding common stock options and warrants at ending market price	974	838
Weighted average shares outstanding based on ending market price	12,933	13,932
Fully Diluted EPS based on ending market price	\$ 0.79	\$ 0.80

(1) The calculation of earnings per share for the year ended December 31, 1996 excludes common stock equivalents because they are anti-dilutive in the year of a loss.

## EXHIBIT 21.1

## ITRON SUBSIDIARIES AND AFFILIATED COMPANIES

Itron, Inc. (Washington)  
Corporate Headquarters  
2818 N. Sullivan Rd.  
Spokane, WA. 99216-1897  
P.O. Box 15288 Spokane, WA. 99215-5288

Itron Canada, Ltd. (Canada)  
160 Wilkinson Rd., #22  
Brampton, ON. L6T 4Z4

Itron S.A. (France)  
Immeuble Merblanc  
1, rue du Port au Prince  
38200 Vienne, Lyon, France

Itron Ltd. (England)  
Kilnbrook House  
Rose Kiln Lane  
Reading, Berkshire RG2 0BY  
United Kingdom

Itron Australasia Pty Ltd. (Australia)  
BHP Building  
Level 6, 55 Sussex Street  
Sydney, NSW 2000 Australia

Utility Translation Systems, Inc. (North Carolina)  
200 UTS Centre  
5909 Falls of the Neuse Road  
Raleigh, North Carolina, 27609

Itron Manufacturing, Inc.  
2818 N. Sullivan Rd.  
Spokane, WA. 99216-1897  
P.O. Box 15288 Spokane, WA. 99215-5288

Itron Minnesota, Inc.  
2401 North State Street  
Waseca, MN 56093

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM (A) ANNUAL CONSOLIDATED FINANCIAL STATEMENTS OF ITRON, INC. AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH (B) CONSOLIDATED FINANCIAL STATEMENTS.

1,000

YEAR		
	DEC-31-1996	
	JAN-01-1996	
	DEC-31-1996	2,243
		0
		45,128
		(752)
		33,837
		90,743
		101,323
		(29,974)
		187,421
	64,504	0
	0	0
		98,686
		231
187,421		177,584
	177,584	104,708
		104,708
		74,644
		0
		(366)
		(2,134)
		670
	(1,464)	0
		0
		0
		(1,464)
		(.11)
		(.11)