BADGER METER INC
Form 10-Q
October 31, 2006

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the quarterly period ended SEPTEMBER 30, 2006

BADGER METER, INC.

4545 W. BROWN DEER ROAD
MILWAUKEE, WISCONSIN 53223
(414) 355-0400
A Wisconsin Corporation
IRS Employer Identification No. 39-0143280
Commission File No. 1-6706

Indicate by check mark whether the Company (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 Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X]   No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]   Accelerated filer [X]   Non-accelerated filer [ ]

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

Yes [ ]   No [X]

As of October 18, 2006, there were 14,098,558 shares of Common Stock outstanding with a par value of $1 per share.

BADGER METER, INC.

QUARTERLY REPORT ON FORM 10-Q FOR PERIOD ENDED SEPTEMBER 30, 2006

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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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

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

- the success or failure of newer Company products, including the Orion(R) radio frequency mobile AMR system, the absolute digital encoder (ADE(TM)) and the Galaxy(R) fixed network AMR system;

- changes in competitive pricing and bids in both the domestic and foreign marketplaces, and particularly in continued intense price competition on government bid contracts for lower cost, local read meters;

- the actions (or lack thereof) of the Company's competitors;

- changes in the Company's relationships with its alliance partners, primarily its alliance partners that provide AMR connectivity solutions, and particularly those that sell products that do or may compete with the Company's products;

- changes in the general health of the United States and foreign economies, including housing starts in the United States and overall industrial activity;

- increases in the cost and/or availability of needed raw materials and parts, including recent increases in the cost of brass housings as a result of increases in the commodity prices for copper and zinc at the supplier level and resin as a result of increases in petroleum and natural gas prices;

- the ability of the Company to shut down its French operations in an orderly fashion and to maximize the value of the related assets;

- changes in foreign economic conditions, particularly currency fluctuations between the United States dollar and the euro;

- the loss of certain single-source suppliers; and

- changes in laws and regulations, particularly laws dealing with the use of lead (which can be used in the manufacture of certain meters incorporating brass housings) and Federal Communications Commission rules affecting the use and/or licensing of radio frequencies necessary for AMR products.

All of these factors are beyond the Company's control to varying degrees. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward looking statements and are cautioned not to place undue reliance on such forward looking statements. The forward looking statements made in this document are made only as of the date of this document and the Company assumes no obligation, and disclaims any obligation, to update any such forward looking statements to reflect subsequent events or circumstances.

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PART I - FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

BADGER METER, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

	September 30, 2006 (Unaudited)	December 31, 2005
	(In thousands)	
ASSETS		
Current assets:		
Cash	$ 4,281	$ 4,403
Receivables	41,317	30,450

Inventories:		
Finished goods	10,395	11,875
Work in process	8,108	9,048
Raw materials	14,302	11,047
Total inventories	32,805	31,970
Prepaid expenses	2,595	2,309
Deferred income taxes	3,480	3,432
Total current assets	84,478	72,564
Property, plant and equipment, at cost	116,518	109,810
Less accumulated depreciation	(70,343)	(65,940)
Net property, plant and equipment	46,175	43,870
Intangible assets, at cost less accumulated amortization	942	1,026
Prepaid pension	16,370	17,726
Other assets	3,915	4,101
Goodwill	6,842	6,580
Total assets	$158,722	$145,867
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$ 21,612	$ 8,847
Current portion of long-term debt	3,810	7,431
Payables	16,142	11,484
Accrued compensation and employee benefits	5,632	6,436
Warranty and after-sale costs	3,349	3,610
Income and other taxes	1,897	1,778
Total current liabilities	52,442	39,586
Other long term liabilities	576	634
Deferred income taxes	6,596	6,584
Accrued non-pension postretirement benefits	4,220	3,955
Other accrued employee benefits	6,246	6,332
Long-term debt	6,476	15,360
Commitments and contingencies		
Shareholders' equity:		
Common stock	20,494	20,112
Capital in excess of par value	15,529	13,320
Reinvested earnings	78,814	74,258
Accumulated other comprehensive income	790	1
Less: Employee benefit and nonvested stock	(795)	(1,357)
Treasury stock, at cost	(32,666)	(32,918)
Total shareholders' equity	82,166	73,416
Total liabilities and shareholders' equity	$158,722	$145,867

See accompanying notes to consolidated condensed financial statements.

BADGER METER, INC.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

	Three Months Ended September 30,		Nine Months Ended September 30,	
	(Unaudited)		(Unaudited)	
	(In thousands except share and per share amounts)			
	2006	2005	2006	2005
Net sales	$ 62,980	$ 54,194	$ 186,421	$ 166,058
Cost of sales	46,679	35,540	128,413	107,965
Gross margin	16,301	18,654	58,008	58,093
Selling, engineering and administration	14,363	12,156	40,692	37,610
Operating earnings	1,938	6,498	17,316	20,483
Interest expense	511	402	1,312	1,177
Earnings before income taxes	1,427	6,096	16,004	19,306
Provision for income taxes	1,946	2,285	8,243	7,780
Net earnings (loss)	$ (519)	$ 3,811	$ 7,761	$ 11,526
Per share amounts:				
Earnings (loss) per share:				
Basic	$ (.04)	$ .28	$ .56	$ .86
Diluted	$ (.04)	$ .27	$ .55	$ .82
Dividends declared:	$ .080	$ .075	$ .230	$ .215
Shares used in computation of earnings (loss) per share:				
Basic	13,935,229	13,522,144	13,831,668	13,458,804
Impact of stock-based compensation (a)	--	672,704	375,642	549,733
Diluted	13,935,229	14,194,848	14,207,310	14,008,537

(a) As a result of the loss recognized in the third quarter of 2006, the impact of potential common shares related to stock-based compensation is anti-dilutive and therefore excluded from the weighted average shares outstanding used to calculate dilutive loss per share.

See accompanying notes to consolidated condensed financial statements.

BADGER METER, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

Nine Months Ended September 30,

	(Unaudited) (In thousands) 2006	2005
Operating activities:		
Net earnings	$ 7,761	$11,526
Adjustments to reconcile net earnings to net cash provided by (used for) operations:		
Depreciation	5,004	4,721
Amortization	235	147
Long-term asset impairment	1,288	--
Tax benefit on stock options	--	877
Deferred income taxes	(32)	(25)
Noncurrent employee benefits	3,204	2,666
Contributions to pension plan	--	(2,000)
Changes in:		
Receivables	(10,455)	(7,826)
Inventories	(390)	1,802
Prepaid expenses	(278)	(513)
Current liabilities other than debt	(55)	2,906
Total adjustments	(1,479)	2,755
Net cash provided by operations	6,282	14,281
Investing activities:		
Property, plant and equipment	(7,941)	(5,536)
Other - net	(256)	(293)
Net cash used for investing activities	(8,197)	(5,829)
Financing activities:		
Net increase (decrease) in short-term debt	12,400	(7,917)
Issuance of long-term debt	--	10,000
Repayments of long-term debt	(12,504)	(6,891)
Dividends paid	(3,206)	(2,899)
Proceeds from exercise of stock options	2,326	1,288
Tax benefit on stock options	2,502	--
Treasury stock purchases	--	(2,958)
Issuance of treasury stock	365	840
Net cash provided by (used for) financing activities	1,883	(8,537)
Effect of exchange rate on cash	(90)	330
Increase (decrease) in cash	(122)	245
Cash - beginning of period	4,403	2,834
Cash - end of period	$ 4,281	$ 3,079

See accompanying notes to consolidated condensed financial statements.

BADGER METER, INC.

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited consolidated condensed financial statements of Badger Meter, Inc. (the "Company") contain all adjustments (consisting only of normal recurring accruals except as otherwise discussed) necessary to present fairly the Company's consolidated condensed financial position at September 30, 2006, results of operations for the three- and nine-month periods ended September 30, 2006 and 2005, and cash flows for the nine-month periods ended September 30, 2006 and 2005. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

On April 28, 2006, the Board of Directors declared a 2-for-1 stock split on the Company's Common Stock effected in the form of a 100% stock dividend, payable on June 15, 2006 to shareholders of record at the close of business on June 1, 2006. In this report, all the per share amounts and numbers of shares have been restated to reflect this stock split. In addition, Common Stock and capital in excess of par value have been adjusted to reflect this split for all periods presented.

Certain other reclassifications have been made to the 2005 consolidated condensed financial statements to conform to the 2006 presentation.

NOTE 2 ADDITIONAL BALANCE SHEET INFORMATION

The consolidated condensed balance sheet at December 31, 2005 was derived from amounts included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. Refer to the footnotes to the financial statements included in that report for a description of the Company's accounting policies and for additional details of the Company's financial condition. The details in those notes have not changed except as discussed below and as a result of normal adjustments in the interim.

GOODWILL Goodwill increased from $6.6 million at December 31, 2005 to $6.8 million at September 30, 2006 as a result of translation adjustments for goodwill denominated in foreign currencies.

WARRANTY AND AFTER-SALE COSTS The Company estimates and records provisions for warranties and other after-sale costs in the period the sale is reported. After-sale costs represent a variety of activities outside of the written warranty policy, such as investigation of unanticipated problems after the customer has installed the product, or analysis of water quality issues. Changes in the Company's warranty and after-sale costs reserve for the nine-month periods ended September 30, 2006 and 2005 are as follows:

(In thousands)	Balance at beginning of year	Net additions charged to earnings	Costs incurred	Balance at September 30
2006	$3,610	$1,107	$(1,368)	$3,349

2005	$3,817	$1,182	$(1,343)	$3,656

STOCK-BASED COMPENSATION PLANS At September 30, 2006, the Company has two types of stock-based employee compensation plans, which are described more fully in Note 1 "Summary of Significant Accounting Policies" under the heading "Stock-Based Compensation Plans" and Note 5 "Stock Option Plans" in the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company's 2005 Annual Report on Form 10-K.

The Company recognizes the cost of stock-based awards for all of its stock-based compensation plans on a straight-line basis over the vesting period of the awards. Total stock compensation expense recognized by the Company for the three- and nine-month periods ended September 30, 2006 was $239,000 and $750,000, respectively, compared to $79,000 and $185,000 for the same periods in 2005.

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Stock Options:

The Company has six stock option plans which provide for the issuance of options to key employees and directors of the Company. Each plan authorizes the issuance of options to purchase up to an aggregate of 800,000 shares of Common Stock, with vesting periods of up to ten years and maximum option terms of ten years. As of September 30, 2006, options to purchase 547,776 shares remain available for grant under three of these plans.

Prior to January 1, 2006, the Company accounted for stock compensation plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees," and related Interpretations, as permitted by Financial Accounting Standards Board (FASB) Statement No. 123 (SFAS 123), "Accounting for Stock-Based Compensation." No stock-based employee compensation cost was recognized for stock option awards in the Consolidated Statements of Operations for the periods prior to January 1, 2006 as all options granted under those plans had an exercise price equal to the market value of the underlying Common Stock on the date of grant.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R) (SFAS 123(R)), "Share-Based Payment," using the modified-prospective-transition method. Under this transition method, compensation cost recognized in the third quarter and first nine months of 2006 includes compensation costs for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 and compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). The Company estimated the fair value of its option awards granted prior to January 1, 2006 using the Black-Scholes option-pricing formula, and continued to use this model. The Company records compensation expense for stock options ratably over the stock option plans' vesting period. Results for prior periods have not been restated.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company's earnings before income taxes and net loss for the three-month period ended September 30, 2006 were $30,000 lower and $14,000 higher, respectively, than if the Company had continued to account for share-based compensation under APB 25. For the nine-month period ended September 30, 2006, earnings before income taxes and net earnings were $241,000 and $165,000 lower, respectively.

Prior to the adoption of SFAS 123(R), the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Consolidated Condensed Statements of Cash Flows. SFAS 123(R) requires the cash flows resulting from the tax benefits of the tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

The following table illustrates the effects on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock option plans during the three and nine months ended September 30, 2005. These pro forma calculations only include the effects of stock-based compensation granted since January 1, 1995. The value of the options (net of forfeitures) is amortized to expense on a straight-line basis over their vesting periods.

(In thousands except per share amounts)	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net earnings, as reported	$3,811	$11,526
Deduct: Incremental stock-based compensation determined under fair value based method for all awards since January 1, 1995, net of related tax effects	(78)	(216)
Pro forma net earnings	$3,733	$11,310
Earnings per share:		
Basic, as reported	$ .28	$ .86
Basic, pro forma	$ .28	$ .84
Diluted, as reported	$ .27	$ .82
Diluted, pro forma	$ .26	$ .81

The following table summarizes the stock option transactions for the nine-month periods ended September 30:

	2006		2005	
(In thousands except per share amounts)	Options	Weighted average exercise price	Options	Weighted average exercise price
Options outstanding at January 1	1,290	$ 7.35	1,618	$ 7.01
Options granted	28	$31.41	45	$19.17
Options exercised	(335)	$ 6.94	(301)	$ 7.19
Options forfeited/cancelled	(2)	$ 7.99	(38)	$ 7.89
Options outstanding at September 30	981	$ 8.17	1,324	$ 7.36

Exercisable at September 30	669	$ 7.02	785	$ 7.08
	=====		=====	

The following assumptions were used for options granted in the nine-month periods ended September 30:

	2006	2005
Per share fair value of options granted during the period	$11.62	$12.07
Risk-free interest rate	5%	4%
Dividend yield	.96%	1.4%
Volatility factor	34%	30%
Weighted-average expected life (in years)	5.4	6.1

The following table summarizes the aggregate intrinsic value related to options exercised, outstanding and exercisable as of and for the nine-month periods ended September 30:

(In thousands)	2006	2005
Exercised	$ 7,076	$ 3,556
Outstanding	$16,686	$19,260
Exercisable	$12,113	$11,630

Stock options outstanding at September 30, 2006 are as follows (options in thousands):

Price Range	Weighted average contractual life	Options	Weighted average exercise price
$3.70 - $ 5.75	2.9	312	$ 5.66
$6.03 - $ 7.13	5.9	377	$ 7.05
$7.50 - $31.42	4.6	292	$12.31
	---	---	
Options outstanding	4.8	981	$ 8.17
	===	===	
Options exercisable	4.0	669	$ 7.02
	===	===	

As of September 30, 2006, the unrecognized compensation cost related to stock options is approximately $610,000 ($396,000 on an after-tax basis) which will be recognized over a weighted average period of 2.7 years.

Nonvested Stock:

Director Stock Grant Plan: Non-employee directors receive an annual award of 1,200 shares of Common Stock under the shareholder-approved 2002 Director Stock

Grant Plan. The Company records compensation expense for this plan ratably over the annual service period beginning May 1. Director stock compensation expense recognized by the Company for the three- and nine-month periods ended September 30, 2006 was $43,000 and $156,000, respectively, compared to $32,000 and $106,000 of compensation expense recognized for the same periods in 2005. As of September 30, 2006, the unrecognized compensation cost related to the nonvested director stock award that is expected to be recognized over the remaining seven months is estimated to be approximately $106,000 ($66,000 on an after-tax basis).

Restricted Stock: On April 28, 2005, a restricted stock plan was approved which provides for the issuance of nonvested Common Stock to certain eligible employees. The Company records compensation expense for this plan ratably over the vesting period. The plan authorizes the issuance of up to an aggregate of 100,000 shares of Common Stock, of which 31,000 shares were issued in the second quarter of 2005 and 48,000 were issued in the second quarter of 2006. Nonvested stock awards have a three-year cliff vesting period contingent on

employment. Nonvested stock compensation expense recognized by the Company for the three- and nine-month periods ended September 30, 2006 was $166,000 and $352,000, respectively, compared to $47,000 and $79,000 for the three- and nine-month periods ended September 30, 2005.

The fair value of nonvested shares is determined based on the market price of the Company's shares on the grant date.

(In thousands except per share amounts)	Shares	Fair value per share
Nonvested at January 1	31	$18.33
Granted	48	$31.41
Vested	(1)	$18.33
Forfeited	--	--
Nonvested at September 30, 2006	78	$26.40

As of September 30, 2006, there was $1.5 million ($960,000 on an after-tax basis) of unrecognized compensation cost related to non-vested restricted stock that is expected to be recognized over a weighted average period of 2.3 years.

NOTE 3 EMPLOYEE BENEFIT PLANS

The Company maintains a non-contributory defined benefit pension plan for its domestic employees and a non-contributory postretirement plan that provides medical benefits for certain domestic retirees and eligible dependents. The following table sets forth the components of net periodic benefit cost for the three months ended September 30, 2006 and 2005 based on a September 30 measurement date:

Other

(In thousands)	Pension benefits 2006	Pension benefits 2005	postretirement benefits 2006	postretirement benefits 2005
Service cost	$ 485	$ 457	$ 56	$ 44
Interest cost	595	625	122	125
Expected return on plan assets	(918)	(910)	--	--
Amortization of prior service cost	(28)	(29)	(9)	(45)
Amortization of net loss	318	248	59	40
Net periodic benefit cost	$ 452	$ 391	$228	$164

The following table sets forth the components of net periodic benefit cost for the nine months ended September 30, 2006 and 2005 based on a September 30 measurement date:

(In thousands)	Pension benefits 2006	Pension benefits 2005	Other postretirement benefits 2006	Other postretirement benefits 2005
Service cost	$ 1,455	$ 1,371	$168	$ 132
Interest cost	1,785	1,875	365	375
Expected return on plan assets	(2,754)	(2,730)	--	--
Amortization of prior service cost	(84)	(87)	(27)	(135)
Amortization of net loss	954	744	178	120
Net periodic benefit cost	$ 1,356	$ 1,173	$684	$ 492

The Company did not make a contribution in 2006, because the return on assets as of the annual measurement date of September 30, 2006 was sufficient.

The Company also disclosed in its financial statements for the year ended December 31, 2005 that it estimated it would pay $1.0 million in other postretirement benefits in 2006. As of September 30, 2006, $741,000 of such benefits were paid. The Company continues to believe that its estimated payments for the full year are reasonable. Note that the amount of benefits paid in calendar year 2006 will not impact the expense for postretirement benefits for the current year.

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NOTE 4 GUARANTEES

The Company guarantees the debt of the Badger Meter Officers' Voting Trust ("BMOVT"), from which the BMOVT obtained loans from a bank on behalf of the officers of the Company in order to purchase shares of the Company's Common Stock. The officers' loan amounts are collateralized by the Company's shares that were purchased with the loans' proceeds. There have been no loans made to officers by the BMOVT since July 2002. The Company has guaranteed $0.5 million

and $1.1 million of the BMOVT's debt at September 30, 2006 and December 31, 2005, respectively. The current loan matures in April 2007, at which time it is expected to be renewed. The fair market value of this guarantee at September 30, 2006 continues to be insignificant because the collateral value of the shares exceeds the loan amount. It is the Company's intention to eliminate the BMOVT by December 31, 2010, because it no longer fulfills its original purpose of providing officers with loans to purchase Common Stock. The Company has no other off-balance sheet arrangements.

The Company guarantees the outstanding debt of the Badger Meter Employee Savings and Stock Ownership Plan ("ESSOP") that is recorded in long-term debt, offset by a similar amount of unearned compensation that has been recorded as a reduction of shareholders' equity. The loan amount is collateralized by shares of the Company's Common Stock. A payment of $120,000 in the first quarter of 2006 reduced the loan from $0.9 million at December 31, 2005 to $0.8 million at September 30, 2006.

NOTE 5 COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) of ($0.5) million and $3.6 million were recognized for the three-month periods ended September 30, 2006 and 2005, respectively. Foreign currency translation adjustments included in comprehensive income (loss) for the three-month periods ended September 30, 2006 and 2005 were a $27,000 gain and a ($0.2) million loss, respectively. Total comprehensive income was $8.6 million and $9.7 million for the nine-month periods ended September 30, 2006 and 2005, respectively. Foreign currency translation adjustments included in comprehensive income for the nine-month periods ended September 30, 2006 and 2005 were a $0.8 million gain and a ($1.8) million loss, respectively.

NOTE 6 FRENCH OPERATIONS SHUTDOWN

Throughout 2006, the Company continued to evaluate strategic alternatives with respect to its subsidiaries in Nancy, France, including potential restructuring, sale or shutdown. In the third quarter of 2006, the Company began the process under French law to obtain the required approvals to shut down the operations.

In the third quarter of 2006, the Company also recorded $3.7 million of after-tax charges related to the anticipated shutdown of its French operations. These charges included increased reserves for receivables and inventories totaling $1.9 million, recording an impairment of long-lived assets of $1.3 million (primarily included in selling, engineering and administration in the Consolidated Condensed Statement of Operations), and recognizing liabilities for legally required severance costs of $0.5 million. The long-lived asset group includes the intangible assets and fixed assets of the French operations. As a result of the continued operating losses, the anticipated shutdown of the Company's French operations, and the carrying amount of the long-lived asset group exceeding the expected undiscounted future cash flows, the impairment charge of $1.3 million was recognized for the difference between the carrying value of the asset group and the fair value, based on an appraisal.

See Note 10 Subsequent Event for further discussion of action taken subsequent to September 30, 2006 and anticipated future costs associated with the shutdown of the Company's French operations.

NOTE 7 INCOME TAXES

The provision for income taxes differs from the amount that would be provided by applying the statutory U.S. corporate income tax rate. The effective tax rate for the third quarter of 2006 was 136.4% compared to 37.5% for the same period in 2005, and 51.5% compared to 40.3% for the nine-month periods ended September 30, 2006 and 2005, respectively. The effective tax rates for the third quarter and nine months ended September 30, 2006 were affected by the shutdown charges recorded as a result of the anticipated shutdown of the Company's French operations. Additionally, the effective tax rates were also higher than the statutory rate due to the continuing operating losses from the French operations. Consistent with prior periods, no tax benefit was taken for French-related operating losses due to uncertainties surrounding the ultimate realization of such benefits.

NOTE 8 CONTINGENCIES AND LITIGATION

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

The Company is subject to contingencies relative to environmental laws and regulations. Currently, the Company is in the process of resolving matters relative to two landfill sites. Provision has been made for all known settlement costs, which are not material.

The Company is also a defendant in numerous multi-party asbestos lawsuits pending in various states. These lawsuits assert claims alleging that certain industrial products were manufactured by the defendants and were the cause of injury and harm. The Company is vigorously defending itself against these claims. Although it is not possible to predict the ultimate outcome of these matters, the Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole.

The Company has evaluated its worldwide operations to determine whether any risks and uncertainties exist that could severely impact its operations in the near term. The Company does not believe that there are any significant risks. However, the Company relies on single suppliers for certain castings and components in several of its product lines. Although alternate sources of supply exist for these items, loss of certain suppliers could temporarily disrupt operations in the short term. The Company attempts to mitigate these risks by working closely with key suppliers, purchasing minimal amounts from alternative suppliers and by purchasing business interruption insurance where appropriate.

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

NOTE 9 ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The

interpretation prescribes a recognition threshold and measurement attribute criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company is required to adopt FIN 48 on January 1, 2007 and is currently evaluating the impact that the adoption of FIN 48 will have on its consolidated financial condition, results of operations and cash flows.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS 158), which requires the Company to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in the balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Additionally, SFAS 158 requires the Company to measure the funded status of a plan as of the date of its fiscal year-end. The requirement to recognize the funded status of a defined benefit postretirement plan and the related disclosure requirements are effective for the Company as of December 31, 2006, while the requirement to measure the funded status as of fiscal year-end is not effective for the Company until December 31, 2008. The company is currently evaluating the impact that the adoption of SFAS 158 will have on its consolidated financial position, results of operations and cash flows.

NOTE 10 SUBSEQUENT EVENT

On October 16, 2006, the Board of Directors authorized management to shut down the Company's French subsidiaries. French operations are expected to cease by the end of fiscal 2006. The Company currently estimates that the shutdown of the French subsidiaries will result in after-tax charges ranging from $6.0 million to $8.0 million. In the third quarter of 2006, $3.7 million of after-tax charges were recognized, with the remainder to be recognized as the operations wind down, assets are liquidated and liabilities are settled. Upon substantial completion of the shutdown, the results of operations will be eliminated from the continuing operations of the Company and be presented as discontinued operations.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

BUSINESS DESCRIPTION AND OVERVIEW

The Company is a leading marketer and manufacturer of products using flow measurement and control technologies developed both internally and with other technology companies. Its products are used to measure and control the flow of liquids in a variety of applications. The Company's product lines fall into two general categories, utility and industrial. The utility category is comprised of two product lines, residential and commercial water meters (with various automatic meter reading (AMR) technology systems), which are generally sold to water utilities and constitute a majority of the Company's sales. Industrial product line sales comprise the remainder of the Company's sales and include automotive fluid meters and systems, small precision valves, electromagnetic meters, impeller flow meters and industrial process meters (all

with related accessories and instrumentation).

Residential and commercial water meters and related systems are classified as local (or manual) read meters or AMR products. Local read meters consist of a water meter and a register. With AMR meters, the register digitally encodes the mechanical reading and its radio frequency transmitter communicates the data to a computerized system that collects the data and sends it to specific utility computerized programs. Net sales and the corresponding net earnings depend on unit volume and mix of products, with the Company generally earning higher margins on residential AMR products (the impact of AMR on commercial products is not as significant given the higher sales prices of commercial meters). The Company sells AMR products of other companies as well as its own proprietary product, Orion(R), which has higher margins than the other AMR products. Net sales and the corresponding net earnings are therefore also dependent on the mix of AMR products between proprietary and non-proprietary products. Orion(R) is currently being sold as a walk-by/drive-by system, but also has the ability to connect with a variety of other technologies, such as power line carrier, broadband over power line, municipal WI-FI and radio frequency systems to allow for remote reading of the data.

There is a base level of annual business for utility products driven by replacement units and, to a lesser extent, housing starts. Sales above the base level depend on conversions to AMR away from manual read meters. The Company believes that conversion from local read meters to AMR products can accelerate replacements of meters and result in growth, because it is estimated that only 20-25% of the water meter market has been converted to AMR. Badger Meter's strategy is to solve customers' metering needs with its proprietary meter reading systems or other systems available through alliances within the marketplace.

The industrial products generally serve niche markets and have in the past utilized technology derived from utility products to serve industrial uses. As these markets evolve, these products are becoming more specialized to meet industrial flow measurement and communication protocol requirements. Serving these markets allows the Company to expand its technologies into other areas of flow measurement and control, as well as utilize existing capacity and spread fixed costs over a larger sales base.

BUSINESS TRENDS

For several quarters, the Company has carefully evaluated strategic alternatives for its subsidiaries in Nancy, France, including restructuring, sale or shutdown. In the third quarter of 2006, the Company began the process under French law to obtain the approvals to close the operation. On October 16, 2006, the decision was finalized and operations are expected to cease by the end of 2006. The Company currently estimates that this will result in after-tax charges ranging from $6.0 million to $8.0 million. In the third quarter of 2006, $3.7 million of charges were recognized, with the remainder to be recognized as the operations wind down, assets are liquidated and liabilities are settled.

As noted above, the Company sells AMR products of other companies as well as its own proprietary product, Orion(R). The Company currently has a distribution agreement under which it resells products produced by Itron, Inc. Prior to the Company's introduction of its own proprietary Orion(R) products, Itron(R) water utility related products were a significant contributor to the Company's results. The Company's Orion(R) products directly compete with Itron(R) water AMR products and, in recent years, many of the Company's customers have selected Orion(R) products. As a result, the Company's annual 2005 sales of Itron(R) products decreased approximately 12%, while Orion(R)

sales doubled compared to 2004. This trend continued as sales of Itron(R) products decreased approximately 6%, 13% and 17% in the first, second and third quarters of 2006 respectively, while Orion(R) sales increased 43%, 20% and 63% compared to the corresponding periods of 2005. The Company expects this trend to continue, although it also believes that Itron(R) products will remain a significant component of utility sales. Decreases in sales of Itron(R) products have been offset by increases in sales of Orion(R) products, which produce a higher gross margin than the Itron(R) products. As a result, the Company does

not expect this trend to have a material negative impact on the Company's financial position or results of operations.

RESULTS OF OPERATIONS - THREE MONTHS ENDED SEPTEMBER 30, 2006

The net income for the quarter reflects approximately $3.7 million of after-tax charges related to the planned disposal of the Company's French operations. See the discussion above regarding the decision to shut down the Company's French operations. These charges included increasing reserves for receivables and inventories, recording an impairment of long-lived assets, and recognizing liabilities for legally required severance costs. Additional charges are anticipated in future periods as operations wind down and the actual liquidation occurs.

The following tables reconcile consolidated condensed statements of operations to similar data on a pro forma basis and is included to supplement the consolidated condensed financial statements presented in accordance with generally accepted accounting principles (GAAP). Management uses the net earnings (loss) without shutdown charges for the its French operations or without the French operating losses in its internal performance reporting. Management believes that these non-GAAP financial measures are useful for providing investors with additional insight into the Company's operating performance because it eliminates from reported results the effects of the charges associated with the French shutdown and the operating losses from the French operations, both of which will be included in discontinued operations once the liquidation process is completed. Therefore, these non-GAAP financial measures enhance investors' overall understanding of the Company's ongoing operations. Non-GAAP performance measures should be considered in addition to, and not as a substitute for, results prepared in accordance with GAAP.

Pro Forma Consolidated Condensed Statements of Operations

Three Months Ended September 30, 2006
(Unaudited)
(In thousands except share and per share amounts)

	French Operations' Shutdown	Pro Forma Without French Shutdown	Fre Opera

	As Reported	Charges	Charges	Los
Net sales	$ 62,980	$ --	$ 62,980	$
Cost of sales	46,679	(2,047)	44,632	
Gross margin	16,301	(2,047)	18,348	
Selling, engineering and administration	14,363	(2,094)	12,269	
Operating earnings	1,938	(4,141)	6,079	
Interest expense	511	--	511	
Earnings before income taxes	1,427	(4,141)	5,568	
Provision for income taxes	1,946	(399)	2,345	
Pro forma net earnings (loss)	$ (519)	$ (3,742)	$ 3,223	$
Per share amounts:				
As reported and pro forma earnings (loss) per share:				
Basic	$ (.04)	$ (.27)	$ .23	$
Diluted	$ (.04)	$ (.26)	$ .22	$
Shares used in computation of reported and pro forma earnings (loss) per share:				
Basic	13,935,229	13,935,229	13,935,229	13,93
Diluted	13,935,229(a)	14,356,475	14,356,475	14,35

(a) As a result of the loss recognized in the third quarter of 2006, the impact of potential common shares related to stock-based compensation is anti-dilutive and therefore excluded from the weighted average shares outstanding used to calculate dilutive loss per share.

Pro Forma Consolidated Condensed Statements of Operations

Three Months Ended September 30, 2005
(Unaudited)
(In thousands except share and per share amounts)

	As Reported	French Operations' Shutdown Charges	Pro Forma Without French Shutdown Charges	Fren Operat Loss
Net sales	$ 54,194	$--	$ 54,194	$ 3
Cost of sales	35,540	--	35,540	2

Gross margin	18,654	--	18,654	
Selling, engineering and administration	12,156	--	12,156	
Operating earnings	6,498	--	6,498	
Interest expense	402	--	402	
Earnings before income taxes	6,096	--	6,096	
Provision for income taxes	2,285	--	2,285	
Pro forma net earnings (loss)	$ 3,811	$--	$ 3,811	$
Per share amounts:				
As reported and pro forma earnings (loss) per share:				
Basic	$ .28	$--	$ .28	$
Diluted	$ .27	$--	$ .27	$
Shares used in computation of reported and pro forma earnings (loss) per share:				
Basic	13,522,144	--	13,552,144	13,552
Diluted	14,194,848	--	14,194,848	14,194

Net sales for the three-month period ended September 30, 2006 increased $8.8 million, or 16.2%, over the same period in 2005. The overall sales increase was driven by increased sales in both local read and AMR meters as well as significant increases in commercial meters, all caused by volume increases, and by higher industrial sales.

Residential and commercial water meter sales represented 78.4% of total sales in the third quarter of 2006 compared to 75.2% in the third quarter of 2005. These sales increased $8.6 million to $49.4 million compared to $40.8 million in the same period in 2005 due to increased sales of local (or manual) read water meter units, units utilizing AMR technologies and commercial meters. Most notable in the increase of AMR technologies was the increase in sales of the Company's proprietary AMR product, Orion(R), which increased approximately 63% over the amount sold in the third quarter of 2005. The increase in Orion(R) sales was somewhat offset by sales decreases in other AMR technologies, particularly Itron(R).

Industrial sales were affected by economic conditions, domestically and internationally, in each of the markets served by the various product lines. In total, industrial products represented 21.6% of total sales for the three months ended September 30, 2006 compared to 24.8% for the same period in 2005. Industrial sales increased $0.2 million to $13.6 million in the third quarter of 2006 compared to $13.4 million in the third quarter of 2005. The increase in sales was driven primarily by higher sales of electromagnetic meters, automotive fluid meters and valves, offset somewhat by lower sales of automotive systems sold by the Company's French subsidiary.

Gross margins in total for the third quarter of 2006 were 25.9%, which includes the effects of the French shutdown charges. Without the Company's French shutdown charges and operating results, the gross margins would have been 29.7% compared to 35.9% in the third quarter of 2005 on a pro forma basis. (See the discussion above on non-GAAP financial measures.) The decrease in this pro forma gross margin was due to the Company experiencing considerable cost increases on purchased castings due to increased prices of raw material metals, particularly copper, which is a main component in purchased brass castings. The Company was unable to recoup all of these cost increases in the third quarter, although price increases were implemented in August 2006 to recover a portion of

the increased cost of materials. It is the Company's belief that it will take several quarters for the price increases to fully offset the increased costs. Gross margins were also negatively

affected by the net impact of lower margins on automotive fluid meters and related systems due to competition and to charges associated with the development and introduction of a fixed-based technology product. These were offset somewhat by higher residential meter margins due to the higher mix of AMR products, particularly the Orion(R) product, which carries higher margins.

Selling, engineering and administration costs for the third quarter of 2006 increased 18.2% over the same period in 2005 due primarily to the shutdown charges for the French operations. Without the Company's French shutdown and operating charges, these expenses were essentially flat between periods on a pro forma basis, reflecting continuing cost containment efforts, offset by normal inflationary pressures. (See the discussion above on non-GAAP financial measures.) In addition, the third quarter of 2006 includes $30,000 of additional compensation expense due to expensing stock options to comply with SFAS 123(R), "Share-Based Payment".

Interest expense for the third quarter of 2006 was $0.1 million higher than the same period in the prior year primarily due to higher interest rates.

The effective tax rate for the third quarter of 2006 was 136.4% due to the uncertainty of tax benefiting certain of the French shutdown charges, compared to 37.5% for the third quarter of 2005. Without the Company's French shutdown charges and operating charges, the effective tax rate would be 38.1% compared to 34.4% in the third quarter of 2005. (See the discussion above on non-GAAP financial measures.) The lower than anticipated rate on a pro forma basis for the third quarter of 2005 was the result of adjustments made to the annual estimated rate.

As a result of the above-mentioned items, there was a ($0.5) million net loss for the third quarter of 2006. On a diluted earnings per share basis, this equated to ($0.04) per share. Without the Company's French shutdown charges and operating charges, pro forma net earnings for the third quarter of 2006 were $3.8 million compared to net earnings in the third quarter of 2005 of $4.4 million, or $0.27 compared to $0.31, respectively, on a diluted earnings per share basis. (See the discussion above on non-GAAP financial measures.)

RESULTS OF OPERATIONS - NINE MONTHS ENDED SEPTEMBER 30, 2006

The net income for the year-to-date results reflects approximately $3.7 million of after-tax charges related to the planned shutdown of the Company's French operations. See the discussion above regarding the decision to shut down the Company's French operations. These charges included increasing reserves for receivables and inventories, recording an impairment of long-lived assets, and recognizing liabilities for legally required severance costs. Additional charges are anticipated in future periods as operations wind down and the actual liquidation occurs.

The following tables reconcile consolidated condensed statements of operations to similar data on a pro forma basis and is included to supplement the consolidated condensed financial statements presented in accordance with generally accepted accounting principles (GAAP). Management uses the net earnings (loss) without shutdown charges for the Company's French operations or without the French operating losses in its internal performance reporting. Management believes that these non-GAAP financial measures are useful for providing investors with additional insight into the Company's operating performance because it eliminates from reported results the effects of the charges associated with the French shutdown and the operating losses from the French operations, both of which will be included in discontinued operations once the liquidation process is completed. Therefore, these non-GAAP financial measures enhance investors' overall understanding of the Company's ongoing operations. Non-GAAP performance measures should be considered in addition to, and not as a substitute for, results prepared in accordance with GAAP.

Pro Forma Consolidated Condensed Statements of Operations

Nine Months Ended September 30, 2006
(Unaudited)
(In thousands except share and per share amounts)

	As Reported	French Operations' Shutdown Charges	Pro Forma Without French Shutdown Charges	French Operating Losses	Pro Form Without French Shutdown Operatin Losses
Net sales	$ 186,421	$ --	$ 186,421	$ 9,393	$ 177,0
Cost of sales	128,413	(2,047)	126,366	8,846	117,5
Gross margin	58,008	(2,047)	60,055	547	59,5
Selling, engineering and administration	40,692	2,094	38,598	2,937	35,6
Operating earnings	17,316	(4,141)	21,457	(2,390)	23,8
Interest expense	1,312	--	1,312	146	1,1
Earnings before income taxes	16,004	(4,141)	20,145	(2,536)	22,6
Provision for income taxes	8,243	(399)	8,642	(3)	8,6
Pro forma net earnings (loss)	$ 7,761	$ (3,742)	$ 11,503	$ (2,533)	$ 14,0
Per share amounts:					
As reported and pro forma earnings (loss) per share:					
Basic	$ .56	$ (.27)	$ .83	$ (.18)	$ 1.
Diluted	$ .55	$ (.26)	$ .81	$ (.18)	$.
Shares used in computation of reported and pro forma earnings (loss) per share:					
Basic	13,831,668	13,831,668	13,831,668	13,831,668	13,831,6
Diluted	14,207,310	14,207,310	14,207,310	14,207,310	14,207,3

Pro Forma Consolidated Condensed Statements of Operations

Nine Months Ended September 30, 2005
(Unaudited)
(In thousands except share and per share amounts)

	As Reported	French Operations' Shutdown Charges	Pro Forma Without French Shutdown Charges	French Operating Losses	Pro Form Without French Shutdown Operatin Losses
Net sales	$ 166,058	$--	$ 166,058	$ 11,246	$ 154,8
Cost of sales	107,965	--	107,965	9,268	98,6
Gross margin	58,093	--	58,093	1,978	56,1
Selling, engineering and administration	37,610	--	37,610	2,825	34,7
Operating earnings	20,483	--	20,483	(847)	21,3
Interest expense	1,177	--	1,177	76	1,1
Earnings before income taxes	19,306	--	19,306	(923)	20,2
Provision for income taxes	7,780	--	7,780	23	7,7
Pro forma net earnings (loss)	$ 11,526	$--	$ 11,526	$ (946)	$ 12,4
Per share amounts:					
As reported and pro forma earnings (loss) per share:					
Basic	$ .86	$--	$ .86	$ (.07)	$.
Diluted	$ .82	$--	$ .82	$ (.07)	$.
Shares used in computation of reported and pro forma earnings (loss) per share:					
Basic	13,458,804	--	13,458,804	13,458,804	13,458,8
Diluted	14,008,537	--	14,008,537	14,008,537	14,008,5

Net sales for the nine-month period ended September 30, 2006 increased $20.4 million, or 12.3%, over the same period in 2005. The overall sales increase was driven by increased sales in both local read and AMR meters as well as significant increases in commercial meters, all caused by volume increases.

Residential and commercial water meter sales represented 77.2% of total sales for the first nine months of 2006 compared to 74.4% for the same period in 2005. These sales increased $20.3 million to $143.9 million compared to $123.6 million in the same period in 2005 due to increased sales of local (or

manual) read water meter units, units utilizing AMR technologies, and commercial meters. Most notable in the increase of AMR technologies was the increase in sales of the Company's proprietary AMR product, Orion(R), which increased 40.7% over the amount sold in the first nine months of 2005. This was mitigated somewhat by sales decreases in other AMR technologies, particularly Itron(R).

Industrial sales were affected by economic conditions, domestically and internationally, in each of the markets served by the various product lines. In total, industrial products represented 22.8% of total sales for the nine months ended September 30, 2006 compared to 25.6% for the same period in 2005. Industrial sales increased less than $0.1 million to $42.5 million for the first nine months of 2006 compared to $42.4 million for the same period in 2005. Most industrial product lines had modest increases, while the automotive systems products sold by the Company's French subsidiary decreased.

Gross margins in total for the first nine months of 2006 were 31.1%, which includes the effects of the Company's French shutdown charges. Without the Company's French shutdown charges and operating results, the gross margins would have been 33.6% compared to 36.2% for the same period in 2005 on a pro forma basis. (See the discussion above on non-GAAP financial measures.) This decrease in gross margin was due to the Company experiencing considerable cost increases on purchased castings due to increased prices of raw material metals, particularly copper, which is a main component in purchased brass castings. The Company was unable to recoup all of these cost increases, although price increases were implemented in the third quarter of 2006 to recover a portion of the increased cost of materials. It is the Company's belief that it will take several quarters for the price increases to fully offset the increased costs. Gross margins were also negatively affected by the net impact of lower margins on automotive fluid meters and related systems due to competition and to charges associated with the development and introduction of a fixed-based technology product. These were

offset somewhat by higher residential meter margins due to the higher mix of AMR products, particularly the Orion(R) product, which carries higher margins.

Selling, engineering and administration costs for the nine months ended September 30, 2006 increased 8.2% over the same period in 2005 due in part to the shutdown charges for the French operations. Without the Company's French shutdown and operating charges, these expenses would have increased $0.9 million, or 2.5%, as a result of higher sales levels and normal inflation, offset somewhat by cost containment measures. (See the discussion above on non-GAAP financial measures.) In addition, this nine-month period of 2006 includes $241,000 of additional compensation expense due to expensing stock options to comply with SFAS 123(R), "Share-Based Payment".

Interest expense for the first nine months of 2006 was $0.1 million higher than the same period in the prior year primarily due to higher interest rates.

The effective tax rate for the nine months ended September 30, 2006 was 51.5% which is higher than normal due to the uncertainty of tax benefiting certain of the French shutdown charges, compared to 40.3% for the same period in 2005. Without the Company's French shutdown charges and operating charges, the pro forma effective tax rate would be 38.3% for both the nine months ended September 30, 2006 and 2005. (See the discussion above on non-GAAP financial measures.)

As a result of the above-mentioned items, net income for the nine months ended September 30, 2006 was $7.8 million. On a diluted earnings per share basis, this equated to $0.55 per share. Without the Company's French shutdown and operating charges, pro forma net earnings for this period would have been $14.0 million compared to $12.5 million for the same period in 2005. (See the discussion above on non-GAAP financial measures.) On a pro forma diluted earnings per share basis, the Company earned $0.99 for the nine months ended September 30, 2006 compared to $0.89 for the same period in 2005.

LIQUIDITY AND CAPITAL RESOURCES

The main sources of liquidity for the Company typically are cash provided by operations and borrowing capacity. For the first nine months of 2006, $6.3 million of cash was provided by operations, primarily as the net result of increased earnings adjusted for depreciation and amortization, offset by increased inventory and receivables.

The change in the receivables balance from $30.5 million at December 31, 2005 to $41.3 million at September 30, 2006 was primarily due to increased sales and the timing of certain customer payments. Days' sales outstanding has increased slightly, although the Company believes credit risk is consistent with the prior year.

Inventories at September 30, 2006 have increased $0.8 million to $32.8 million from the December 31, 2005 balance of $32.0 million due primarily to increased sales and higher material costs, particularly on brass castings, offset by increased reserves resulting from the decision to shut down the Company's French operations.

Net property, plant and equipment increased $2.3 million since December 31, 2005. This is the net result of $7.9 million of capital expenditures, $5.0 million of depreciation expense, the effects of currency adjustments, and impairment charges related to the French operations.

Short-term debt and the current portion of long-term debt at September 30, 2006 increased $9.1 million to a combined $25.4 million versus a balance at December 31, 2005 of $16.3 million. Long-term debt decreased to $6.5 million at September 30, 2006 from $15.4 million at December 31, 2005. Overall, the Company's total debt position has increased slightly due to changes in working capital accounts. Total debt is 28.0% of total capitalization (debt and equity) at September 30, 2006 compared to 30.1% at December 31, 2005. At September 30, 2006, none of the Company's debt carried financial covenants or required collateral.

Payables increased to $16.1 million at September 30, 2006 from $11.5 million at December 31, 2005 primarily as a result of the timing of payments and increased inventory levels. Accrued compensation and employee benefits decreased $0.8 million since December 31, 2005 to $5.6 million due to the first quarter 2006 payments of short-term incentive amounts accrued at December 31, 2005, offset somewhat by costs accrued for 2006 year-to-date expenses.

Common stock and capital in excess of par value increased from December 31, 2005 due to new shares issued in connection with the exercise of stock options. Employee benefit stock decreased as a result of a

payment made on the ESSOP loan during the first quarter of 2006, amortization of nonvested stock expense and the adoption of SFAS 123(R), which required the reclassification of amounts from employee benefit stock to capital in excess of par value.

Badger Meter's financial condition remains strong. The Company believes that its operating cash flows, available borrowing capacity, including $31.9 million of unused credit lines, and its ability to raise additional capital provide adequate resources to fund ongoing operating requirements, future capital requirements and the development of new products.

OTHER MATTERS

There are currently no material legal proceedings pending with respect to the Company. The more significant legal proceedings are as follows.

The Company is subject to contingencies relative to environmental laws and regulations. Currently, the Company is in the process of resolving matters relative to two landfill sites. Provision has been made for all known settlement costs, which are not material.

The Company is also a defendant in numerous multi-party asbestos lawsuits pending in various states. These lawsuits assert claims alleging that certain industrial products were manufactured by the defendants and were the cause of injury and harm. The Company is vigorously defending itself against these claims. Although it is not possible to predict the ultimate outcome of these matters, the Company does not believe the ultimate resolution of these issues will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole.

No other risks or uncertainties were identified that could have a material impact on operations and no long-lived assets have become permanently impaired in value.

ACCOUNTING PRONOUNCEMENTS

The Company began expensing the fair value of stock options on January 1, 2006 when it adopted SFAS 123(R), "Share-Based Payment". See Note 2 to the Notes to Unaudited Consolidated Condensed Financial Statements in this Form 10-Q for information regarding this accounting change.

In June 2006, the FASB issued Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a recognition threshold and measurement attribute criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company is required to adopt FIN 48 on January 1, 2007 and is currently evaluating the impact that the adoption of FIN 48 will have on its consolidated financial condition, results of operations and cash flows.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS 158), which requires the Company to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in the

balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Additionally, SFAS 158 requires the Company to measure the funded status of a plan as of the date of its fiscal year-end. The requirement to recognize the funded status of a defined benefit postretirement plan and the related disclosure requirements are effective for the Company as of December 31, 2006, while the requirement to measure the funded status as of fiscal year-end is not effective for the Company until December 31, 2008. The Company is currently evaluating the impact that the adoption of SFAS 158 will have on its consolidated financial position, results of operations and cash flows.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

The Company's off-balance sheet arrangements and contractual obligations are discussed in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the headings "Off-Balance Sheet Arrangements" and "Contractual Obligations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, and have not materially changed since that report was filed.

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ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's quantitative and qualitative disclosures about market risk are included in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Market Risks" in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, and have not materially changed since that report was filed.

ITEM 4 CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), the Company's management evaluated, with the participation of the Company's Chairman, President and Chief Executive Officer and the Company's Senior Vice President - Finance, Chief Financial Officer and Treasurer, the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the quarter ended September 30, 2006. Based upon their evaluation of these disclosure controls and procedures, the Company's Chairman, President and Chief Executive Officer and the Company's Senior Vice President - Finance, Chief Financial Officer and Treasurer concluded that the Company's disclosure controls and procedures were effective as of the end of the quarter ended September 30, 2006 to ensure that material information relating to the Company, including its consolidated subsidiaries, was made known to management by others within those entities as appropriate to allow timely decisions regarding disclosure, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2006, that has materially affected, or is reasonably likely to materially affect, the Company's

internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 6 EXHIBITS

EXHIBIT NO.	DESCRIPTION
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Periodic Financial Report by the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

BADGER METER, INC.

Dated: October 31, 2006

By /s/ Richard A. Meeusen

Richard A. Meeusen
Chairman, President and Chief Executive Officer

By /s/ Richard E. Johnson

Richard E. Johnson
Senior Vice President - Finance, Chief Financial Officer and Treasurer

By /s/ Beverly L.P. Smiley

Beverly L.P. Smiley
Vice President - Controller

BADGER METER, INC.

QUARTERLY REPORT ON FORM 10-Q FOR PERIOD ENDED SEPTEMBER 30, 2006

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Periodic Financial Report by the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.