

BADGER METER INC  
Form 10-Q  
July 22, 2016  
Table of Contents

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

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FORM 10-Q

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Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
for the quarterly period ended June 30, 2016

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BADGER METER, INC.

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4545 W. Brown Deer Road  
Milwaukee, Wisconsin 53223  
(414) 355-0400  
A Wisconsin Corporation  
IRS Employer Identification No. 39-0143280  
Commission File No. 001-06706

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of July 12, 2016, there were 14,548,503 shares of Common stock outstanding with a par value of \$1 per share.

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Table of Contents

BADGER METER, INC.

Quarterly Report on Form 10-Q for the Period Ended June 30, 2016

Index

Page No.

Part I. Financial Information:

Item 1 Financial Statements (unaudited):

Consolidated Condensed Balance Sheets - June 30, 2016 and December 31, 2015 4

Consolidated Statements of Operations - Three and Six Months Ended June 30, 2016 and 2015 5

Consolidated Statements of Comprehensive Income - Three and Six Months Ended June 30, 2016 and 2015 6

Consolidated Condensed Statements of Cash Flows - Six Months Ended June 30, 2016 and 2015 7

Notes to Unaudited Consolidated Condensed Financial Statements 8

Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations 13

Item 3 Quantitative and Qualitative Disclosures about Market Risk 18

Item 4 Controls and Procedures 18

Part II. Other Information:

Item 6 Exhibits 19

Signatures 20

Exhibit Index 21

Table of Contents

Special Note Regarding Forward Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q, as well as other information provided from time to time by Badger Meter, Inc. (the “Company”) or its employees, may contain forward looking statements that involve risks and uncertainties that could cause actual results to differ materially from those in the forward looking statements. The words “anticipate,” “believe,” “estimate,” “expect,” “think,” “should,” “could” and “objective” or similar expressions are used to identify forward looking statements. All such forward looking statements are based on the Company’s then current views and assumptions and involve risks and uncertainties. Some risks and uncertainties that could cause actual results to differ materially from those expressed or implied in forward looking statements include those described in Item 1A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 that include, among other things:

- the continued shift in the Company’s business from lower cost, manually read meters toward more expensive, value-added automatic meter reading (AMR) systems, advanced metering infrastructure (AMI) systems and advanced metering analytics (AMA) systems that offer more comprehensive solutions to customers’ metering needs;
- the success or failure of newer Company products;
- changes in competitive pricing and bids in both the domestic and foreign marketplaces, and continued intense price competition on government bid contracts for lower cost, manually read meters;
- the actions (or lack thereof) of the Company’s competitors;
- changes in the Company’s relationships with its alliance partners, primarily its alliance partners that provide radio solutions, and particularly those that sell products that do or may compete with the Company’s products;
- changes in the general health of the United States and foreign economies, including to some extent such things as the length and severity of global economic downturns, international or civil conflicts that affect international trade, the ability of municipal water utility customers to authorize and finance purchases of the Company’s products, the Company’s ability to obtain financing, housing starts in the United States, and overall industrial activity;
- unusual weather, weather patterns or other natural phenomena, including related economic and other ancillary effects of any such events;
- the timing and impact of government funding programs that stimulate national and global economies, as well as the impact of government budget cuts or partial shutdowns of governmental operations;
- changes in the cost and/or availability of needed raw materials and parts, such as volatility in the cost of brass castings as a result of fluctuations in commodity prices, particularly for copper and scrap metal at the supplier level, foreign-sourced electronic components as a result of currency exchange fluctuations and/or lead times, and plastic resin as a result of changes in petroleum and natural gas prices;
- the Company’s expanded role as a prime contractor for providing complete technology systems to governmental entities, which brings with it added risks, including but not limited to, the Company’s responsibility for subcontractor performance, additional costs and expenses if the Company and its subcontractors fail to meet the timetable agreed to with the governmental entity, and the Company’s expanded warranty and performance obligations;
- the Company’s ability to successfully identify, complete and integrate acquired businesses or products;
- changes in foreign economic conditions, particularly currency fluctuations in the United States dollar, the Euro and the Mexican peso;
- the inability to develop technologically advanced products;
- the failure of the Company’s products to operate as intended;
- the inability to protect the Company’s proprietary rights to its products;
- disruptions and other damages to information technology and other networks and operations due to breaches in data security;
- transportation delays or interruptions;
- the loss of certain single-source suppliers; and
- changes in laws and regulations, particularly laws dealing with the content or handling of materials used in the Company’s products.

All of these factors are beyond the Company's control to varying degrees. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward looking statements contained in this Quarterly Report on Form 10-Q and are cautioned not to place undue reliance on such forward looking statements. The forward looking statements made in this document are made only as of the date of this document and the Company assumes no obligation, and disclaims any obligation, to update any such forward looking statements to reflect subsequent events or circumstances.

Table of Contents

## Part I – Financial Information

## Item 1 Financial Statements

## BADGER METER, INC.

## Consolidated Condensed Balance Sheets

	June 30, (Unaudited) (In thousands)	December 31, (Unaudited) (In thousands)
	2016	2015
Assets		
Current assets:		
Cash	\$7,356	\$ 8,163
Receivables	61,326	56,643
Inventories:		
Finished goods	21,876	28,548
Work in process	16,559	13,184
Raw materials	42,280	36,864
Total inventories	80,715	78,596
Prepaid expenses and other current assets	5,505	5,926
Total current assets	154,902	149,328
Property, plant and equipment, at cost	198,134	194,069
Less accumulated depreciation	(107,381 )	(103,149 )
Net property, plant and equipment	90,753	90,920
Intangible assets, at cost less accumulated amortization	54,328	57,348
Other assets	8,452	8,485
Deferred income taxes	1,380	1,421
Goodwill	47,978	47,978
Total assets	\$357,793	\$ 355,480
Liabilities and shareholders' equity		
Current liabilities:		
Short-term debt	\$53,590	\$ 71,360
Payables	22,175	19,155
Accrued compensation and employee benefits	11,142	9,663
Warranty and after-sale costs	3,513	3,133
Income and other taxes	3,459	1,233
Total current liabilities	93,879	104,544
Other long-term liabilities	4,048	4,809
Deferred income taxes	882	774
Accrued non-pension postretirement benefits	5,893	5,709
Other accrued employee benefits	7,178	7,369
Commitments and contingencies (Note 6)		
Shareholders' equity:		
Common stock	20,557	20,551
Capital in excess of par value	53,587	52,178
Reinvested earnings	215,642	204,044
Accumulated other comprehensive loss	(12,301 )	(12,780 )
Less: Employee benefit stock	(728 )	(768 )

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Treasury stock, at cost	(30,844 )	(30,950 )
Total shareholders' equity	245,913	232,275
Total liabilities and shareholders' equity	\$357,793	\$ 355,480

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

## BADGER METER, INC.

## Consolidated Statements of Operations

	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	(In thousands except share and per share amounts)			
	2016	2015	2016	2015
Net sales	\$103,820	\$ 98,896	\$204,390	\$ 182,540
Cost of sales	64,424	63,753	125,983	117,322
Gross margin	39,396	35,143	78,407	65,218
Selling, engineering and administration	24,474	22,961	50,679	45,983
Operating earnings	14,922	12,182	27,728	19,235
Interest expense, net	228	319	498	636
Earnings before income taxes	14,694	11,863	27,230	18,599
Provision for income taxes	5,294	3,962	9,840	6,471
Net earnings	\$9,400	\$ 7,901	\$17,390	\$ 12,128
Earnings per share:				
Basic	\$0.65	\$ 0.55	\$1.20	\$ 0.84
Diluted	\$0.65	\$ 0.55	\$1.20	\$ 0.84
Dividends declared per common share	\$0.20	\$ 0.19	\$0.40	\$ 0.38
Shares used in computation of earnings per share:				
Basic	14,443,539	14,379,450	14,434,397	14,361,464
Impact of dilutive securities	82,166	63,816	79,799	73,096
Diluted	14,525,705	14,443,266	14,514,196	14,434,560

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

BADGER METER, INC.

Consolidated Statements of Comprehensive Income

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	(Unaudited)		(Unaudited)	
	(In thousands)			
	2016	2015	2016	2015
Net earnings	\$9,400	\$7,901	\$17,390	\$12,128
Other comprehensive income (loss):				
Foreign currency translation adjustment	(288 )	536	289	(160 )
Pension and postretirement benefits, net of tax	94	108	190	239
Comprehensive income	\$9,206	\$8,545	\$17,869	\$12,207

See accompanying notes to unaudited consolidated condensed financial statements.



Table of Contents

## BADGER METER, INC.

## Consolidated Condensed Statements of Cash Flows

	Six Months Ended June 30 (Unaudited) (In thousands)	
	2016	2015
Operating activities:		
Net earnings	\$17,390	\$12,128
Adjustments to reconcile net earnings to net cash provided by operations:		
Depreciation	5,603	5,188
Amortization	5,675	4,978
Deferred income taxes	131	—
Noncurrent employee benefits	437	276
Stock-based compensation expense	752	781
Changes in:		
Receivables	(4,652 )	(8,498 )
Inventories	(1,778 )	(359 )
Prepaid expenses and other current assets	122	(1,003 )
Liabilities other than debt	4,016	5,693
Total adjustments	10,306	7,056
Net cash provided by operations	27,696	19,184
Investing activities:		
Property, plant and equipment expenditures	(5,513 )	(7,604 )
Net cash used for investing activities	(5,513 )	(7,604 )
Financing activities:		
Net decrease in short-term debt	(17,810 )	(2,472 )
Dividends paid	(5,791 )	(5,478 )
Proceeds from exercise of stock options	328	1,270
Tax benefit on stock options	—	319
Issuance of treasury stock	441	457
Net cash used for financing activities	(22,832 )	(5,904 )
Effect of foreign exchange rates on cash	(158 )	344
(Decrease) Increase in cash	(807 )	6,020
Cash – beginning of period	8,163	6,656
Cash – end of period	\$7,356	\$12,676

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

## BADGER METER, INC.

## Notes to Unaudited Consolidated Condensed Financial Statements

## Note 1 Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated condensed financial statements of Badger Meter, Inc. (the “Company” or “Badger Meter”) contain all adjustments (consisting only of normal recurring accruals except as otherwise discussed) necessary to present fairly the Company’s consolidated condensed financial position at June 30, 2016, results of operations for the three- and six-month periods ended June 30, 2016 and 2015, comprehensive income for the three- and six-month periods ended June 30, 2016 and 2015, and cash flows for the six-month periods ended June 30, 2016 and 2015. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

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

## Note 2 Additional Financial Information Disclosures

The consolidated condensed balance sheet at December 31, 2015 was derived from amounts included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015. Refer to the footnotes to the financial statements included in that report for a description of the Company’s accounting policies and for additional details of the Company’s financial condition. The details in those notes have not changed except as discussed below and as a result of normal adjustments in the interim.

## Warranty and After-Sale Costs

The Company estimates and records provisions for warranties and other after-sale costs in the period in which the sale is recorded, based on a lag factor and historical warranty claim experience. After-sale costs represent a variety of activities outside of the written warranty policy, such as investigation of unanticipated problems after the customer has installed the product, or analysis of water quality issues. Changes in the Company’s warranty and after-sale costs reserve are as follows:

	Three months ended		Six months ended	
	June 30, 2016	2015	June 30, 2016	2015
(In thousands)				
Balance at beginning of period	\$ 3,561	\$ 1,546	\$ 3,133	\$ 1,739
Net additions charged to earnings	398	672	1,238	1,121
Adjustments to pre-existing warranties	610	232	863	118
Costs incurred	(1,056 )	(90 )	(1,721 )	(618 )
Balance at end of period	\$ 3,513	\$ 2,360	\$ 3,513	\$ 2,360

## Note 3 Employee Benefit Plans

The Company maintains a non-contributory defined benefit pension plan that covers substantially all U.S. employees who were employed at December 31, 2011. After that date, no further benefits are being accrued in this plan. For the frozen pension plan, benefits are based primarily on years of service and, for certain plans, levels of compensation.

The Company also maintains supplemental non-qualified plans for certain officers and other key employees, and an Employee Savings and Stock Option Plan (“ESSOP”) for the majority of the U.S. employees.

The Company additionally has a postretirement healthcare benefit plan that provides medical benefits for certain U.S. retirees and eligible dependents hired prior to November 1, 2004. Employees are eligible to receive postretirement healthcare benefits upon meeting certain age and service requirements. No employees hired after October 31, 2004 are eligible to receive these benefits. This plan requires employee contributions to offset benefit costs.

Table of Contents

The following table sets forth the components of net periodic benefit cost for the three months ended June 30, 2016 and 2015 based on December 31, 2015 and 2014 actuarial measurement dates, respectively:

	Defined pension plan benefits		Other postretirement benefits	
	2016	2015	2016	2015
(In thousands)				
Service cost (benefit) – benefits earned during the year	\$48	\$(2)	\$33	\$34
Interest cost on projected benefit obligations	450	454	65	60
Expected return on plan assets	(538)	(532)	—	—
Amortization of prior service cost	—	—	(7)	13
Amortization of net loss	154	163	—	—
Net periodic benefit cost	\$114	\$83	\$91	\$107

The following table sets forth the components of net periodic benefit cost for the six months ended June 30, 2016 and 2015 based on December 31, 2015 and 2014 actuarial measurement dates, respectively:

	Defined pension plan benefits		Other postretirement benefits	
	2016	2015	2016	2015
(In thousands)				
Service cost – benefits earned during the year	\$55	\$14	\$69	\$74
Interest cost on projected benefit obligations	905	900	129	126
Expected return on plan assets	(1,087)	(1,075)	—	—
Amortization of prior service cost	—	—	(13)	26
Amortization of net loss	311	354	—	—
Net periodic benefit cost	\$184	\$193	\$185	\$226

The Company disclosed in its financial statements for the year ended December 31, 2015 that it was not required to make a minimum contribution to the defined benefit pension plan for the 2016 calendar year. The Company continues to believe no additional contributions will be required during 2016.

The Company also disclosed in its financial statements for the year ended December 31, 2015 that it estimated it would pay \$0.4 million in other postretirement benefits in 2016 based on actuarial estimates. As of June 30, 2016, \$13,000 of such benefits have been paid. The Company continues to believe that its estimated payments for the full year are reasonable. However, such estimates contain inherent uncertainties because cash payments can vary significantly depending on the timing of postretirement medical claims and the collection of the retirees' portion of certain costs. Note that the amount of benefits paid in calendar year 2016 will not impact the expense for postretirement benefits for 2016.

#### Note 4 Accumulated Other Comprehensive Loss

Components of and changes in accumulated other comprehensive loss at June 30, 2016 are as follows:

(In thousands)	Unrecognized pension and postretirement benefits		Foreign currency	Total

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Balance at beginning of period	\$ (11,968 )	\$ (812 )	\$(12,780)
Other comprehensive loss before reclassifications	—	289	289
Amounts reclassified from accumulated other comprehensive loss, net of tax of \$(0.1) million	190	—	190
Net current period other comprehensive income, net of tax	190	289	479
Accumulated other comprehensive loss	\$ (11,778 )	\$ (523 )	\$(12,301)

9

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Table of Contents

Details of reclassifications out of accumulated other comprehensive loss during the six months ended June 30, 2016 are as follows:

(In thousands)	Amount reclassified from accumulated other comprehensive loss
Amortization of defined benefit pension items:	
Prior service benefit (1)	\$ (13 )
Amortization of actuarial loss (1)	311
Total before tax	298
Income tax benefit	(108 )
Amount reclassified out of accumulated other comprehensive loss	\$ 190

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

Components of and changes in accumulated other comprehensive loss at June 30, 2015 are as follows:

(In thousands)	Unrecognized pension and postretirement benefits	Foreign currency	Total
Balance at beginning of period	\$ (11,891 )	\$ 35	\$(11,856)
Other comprehensive income before reclassifications	—	(160 )	(160 )
Amounts reclassified from accumulated other comprehensive loss, net of tax of \$(0.1) million	239	—	239
Net current period other comprehensive income (loss), net of tax	239	(160 )	79
Accumulated other comprehensive loss	\$ (11,652 )	\$ (125 )	\$(11,777)

Details of reclassifications out of accumulated other comprehensive loss during the six months ended June 30, 2015 are as follows:

(In thousands)	Amount reclassified from accumulated other comprehensive loss
Amortization of defined benefit pension items:	
Prior service cost (1)	\$ 27
Amortization of actuarial loss (1)	354
Total before tax	381
Income tax benefit	(142 )
Amount reclassified out of accumulated other comprehensive loss	\$ 239

(1)

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

Note 5 Acquisition

On August 17, 2015, the Company's wholly-owned subsidiary, National Meter & Automation, Inc. ("National Meter"), acquired the assets of United Utilities, Inc. of Smyrna, Tennessee, which was one of the Company's distributors serving Tennessee and Georgia. National Meter will do business in those and additional areas as "United Utilities".

## Table of Contents

The total purchase consideration for the United Utilities assets was \$3.3 million, which included \$0.4 million in cash and settlement of \$2.9 million of pre-existing Company receivables. The Company's allocation of the purchase price at December 31, 2015 included \$0.8 million of receivables, \$0.4 million of inventory, \$0.1 million of property, plant and equipment, \$1.7 million of intangibles, and \$0.3 million of goodwill. The intangible assets acquired are primarily customer relationships with an estimated average useful life of 12 years. The preliminary allocation of the purchase price to the assets acquired was based upon the estimated fair values at the date of acquisition. As of June 30, 2016, the Company had not completed its analysis for estimating the fair value of the assets acquired.

The United Utilities acquisition was accounted for under the purchase method, and accordingly, the results of operations were included in the Company's financial statements from the date of acquisition. The acquisition did not have a material impact on the Company's consolidated financial statements or the notes thereto.

### Note 6 Contingencies, Litigation and Commitments

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

The Company is subject to contingencies related to environmental laws and regulations. The Company is named as one of many potentially responsible parties in two landfill lawsuits. The landfill sites are impacted by the Federal Comprehensive Environmental Response, Compensation and Liability Act and other environmental laws and regulations. At this time, the Company does not believe the ultimate resolution of these matters will have a material adverse effect on the Company's financial position or results of operations, either from a cash flow perspective or on the financial statements as a whole. This belief is based on the Company's assessment of its limited past involvement with these landfill sites as well as the substantial involvement of and government focus on other named third parties with these landfill sites. However, due to the inherent uncertainties of such proceedings, the Company cannot predict the ultimate outcome of any of these matters. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2015 and the first half of 2016 were not material.

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

The Company relies on single suppliers for most brass castings and certain electronic subassemblies in several of its product lines. The Company believes these items would be available from other sources, but that the loss of certain suppliers would result in a higher cost of materials, delivery delays, short-term increases in inventory and higher quality control costs in the short term. The Company attempts to mitigate these risks by working closely with key suppliers, purchasing minimal amounts from alternative suppliers and by purchasing business interruption insurance where appropriate.

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



Note 7 Income Taxes

The provision for income taxes as a percentage of earnings before income taxes for the second quarter of 2016 was 36.0% compared to 33.4% in the second quarter of 2015. The provision for income taxes as a percentage of earnings before income taxes for the first half of 2016 was 36.1% compared to 34.8% in the first half of 2015. Interim provisions are tied to an estimate of the overall annual rate which can vary due to state taxes, the relationship of foreign and domestic earnings, and production credits available. These items cause variations between periods.

Table of Contents

Note 8 Fair Value Measurements of Financial Instruments

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

Note 9 Subsequent Events

The Company evaluates subsequent events at the date of the balance sheet as well as conditions that arise after the balance sheet date but before the financial statements are issued. The effects of conditions that existed at the date of the balance sheet date are recognized in the financial statements. Events and conditions arising after the balance sheet date but before the financial statements are issued are evaluated to determine if disclosure is required to keep the financial statements from being misleading. To the extent such events and conditions exist, if any, disclosures are made regarding the nature of events and the estimated financial effects for those events and conditions. For purposes of preparing the accompanying consolidated financial statements and the notes to these financial statements, the Company evaluated subsequent events through the date the accompanying financial statements were issued.

Note 10 New Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)," which requires lessees to record most leases on their balance sheets. Lessees initially recognize a lease liability (measured at the present value of the lease payments over the lease term) and a right-of-use ("ROU") asset (measured at the lease liability amount, adjusted for lease prepayments, lease incentives received and the lessee's initial direct costs). Lessees can make an accounting policy election to not recognize ROU assets and lease liabilities for leases with a lease term of 12 months or less as long as the leases do not include options to purchase the underlying assets that the lessee is reasonably certain to exercise. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. The ASU is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted for all entities. The ASU is effective for the Company beginning on January 1, 2019 and the standard requires the use of a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. Full retrospective application is prohibited. The Company is continuing to evaluate the impact that the adoption of this guidance will have on its financial condition, results of operations and the presentation of its financial statements.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory (Topic 330)," which requires entities to measure inventories at the lower of cost or net realizable value ("NRV"). This simplifies the evaluation from the current method of lower of cost or market, where market is based on one of three measures (i.e. replacement cost, net realizable value, or net realizable value less a normal profit margin). The ASU does not apply to inventories measured under the last-in, first-out method or the retail inventory method, and defines NRV as the "estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation." The ASU is effective on a prospective basis for the Company beginning on January 1, 2017, with early adoption permitted. The Company is continuing to evaluate the impact that the adoption of this guidance will have on its financial condition, results of operations and the presentation of its financial statements.

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 provides a single principles-based, five-step model to be applied to all contracts with customers. The five

steps are to identify the contract(s) with the customer, to identify the performance obligations in the contract, to determine the transaction price, to allocate the transaction price to the performance obligations in the contract and to recognize revenue when each performance obligation is satisfied. Revenue will be recognized when promised goods or services are transferred to the customer in an amount that reflects the consideration expected in exchange for those goods or services.

In April 2015, the FASB tentatively agreed to delay the effective date of ASU 2014-09 for one year and to permit early adoption by entities as of the original effective dates. In July 2015, the FASB affirmed its proposal to defer the effective date of the ASU, which has since been issued in August 2015. Considering the one year deferral, ASU 2014-09 will be effective for the Company beginning on January 1, 2018 and the standard allows for either full retrospective adoption or modified retrospective adoption. The Company is continuing to evaluate the impact that the adoption of this guidance will have on its financial condition, results of operations and the presentation of its financial statements.

Table of Contents

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

Business Description and Overview

Badger Meter is an innovator in flow measurement, control and communication solutions, serving water utilities, municipalities, and commercial and industrial customers worldwide. The Company's products measure water, oil, chemicals and other fluids, and are known for accuracy, long-lasting durability and for providing and communicating valuable and timely measurement data. The Company's product lines fall into two categories: sales of water meters and related technologies to municipal water utilities (municipal water) and sales of meters to various industries for water and other fluids (flow instrumentation). The Company estimates that over 80% of its products are used in water applications when both categories are grouped together.

Municipal water, the largest category by sales volume, includes mechanical and ultrasonic (electronic) water meters and related technologies and services used by municipal water utilities as the basis for generating water and wastewater revenues. The key market for the Company's municipal water meter products is North America, primarily the United States, because most meters are designed and manufactured to conform to standards promulgated by the American Water Works Association. The majority of water meters sold continues to be mechanical in nature. In recent years, the Company has made inroads in selling ultrasonic water meters. The development of smaller diameter ultrasonic water meters combined with advanced radio technology now provides the Company with the opportunity to sell into other geographical markets, for example Europe, the Middle East and South America. In the municipal water category, sales of water meters and related technologies and services are also commonly referred to as residential or commercial water meter sales, the latter referring to larger sizes of water meters.

Flow instrumentation includes meters and valves sold worldwide to measure and control materials flowing through a pipe or pipeline including water, air, steam, oil, and other liquids and gases. These products are used in a variety of applications, primarily into the following industries: water/wastewater; heating, ventilating and air conditioning (HVAC); oil and gas; chemical and petrochemical; test and measurement; automotive aftermarket; and the concrete construction process. Furthermore, the Company's flow instrumentation technologies are sold to original equipment manufacturers as the primary flow measurement device within a product or system.

Residential and commercial water meters are generally classified as either manually read meters or remotely read meters via radio technology. A manually read meter consists of a water meter and a register that provides a visual totalized meter reading. Meters equipped with radio technology (endpoints) receive flow measurement data from encoder registers attached to the water meter which is encrypted and transmitted via radio frequency to a receiver that collects and formats the data appropriately for water utility billing systems. These remotely read, or mobile, systems are either automatic meter reading (AMR) systems, where a vehicle equipped for meter reading purposes, including a radio receiver, computer and reading software, collects the data from utilities' meters; or fixed network advanced metering infrastructure (AMI) systems, where data is gathered utilizing a network of permanent data collectors or gateway receivers that are always active or listening for the radio transmission from the utilities' meters. AMI systems eliminate the need for utility personnel to drive through service territories to collect meter reading data. These systems provide the utilities with more frequent and diverse data at specified intervals from their meters.

The ORION® family of radio endpoints provides water utilities with a range of industry-leading options for meter reading. These include ORION Mobile (for mobile meter reading), ORION Fixed Network (for traditional fixed network applications), and ORION Cellular (for infrastructure-free meter reading). ORION Mobile makes the migration to fixed network easier for utilities that prefer to start with mobile reading and later adopt fixed network communications, allowing utilities to choose a solution for their current needs and be positioned for their future operational changes.

Critical to the water metering ecosystem is information and analytics. The Company's BEACON® AMA Managed Solution is the latest in metering technology. BEACON AMA combines the BEACON analytical software suite with proven ORION technologies using two-way fixed and cellular networks in a managed solution, improving utilities' visibility of their water consumption and eliminating the need for costly utility managed infrastructure.

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

## Table of Contents

The Company's net sales and corresponding net earnings depend on unit volume and product mix, with the Company generally earning higher margins on meters equipped with radio technology. The Company's proprietary radio products generally result in higher margins than the remarketed, non-proprietary technology products. The Company also sells registers and endpoints separately to customers who wish to upgrade their existing meters in the field.

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

Water meter replacement and the adoption and deployment of new technology comprise the majority of water meter product sales, including radio products. To a much lesser extent, housing starts also contribute to the new product sales base. Over the last decade, there has been a growing trend in the conversion from manually read water meters to radio technology. This conversion rate is accelerating and contributes to an increased water meter and radio solutions base of business. The Company estimates that less than 53% of water meters installed in the United States have been converted to a radio solutions technology. The Company's strategy is to fulfill customers' metering expectations and requirements with its proprietary meter reading systems or other systems available through its alliance partners in the marketplace.

Flow instrumentation products serve flow measurement and control applications across a broad industrial spectrum, occasionally leveraging the same technologies used in the municipal water category. Specialized communication protocols that control the entire flow measurement process and mandatory certifications drive these markets. The Company's specific flow measurement and control applications and technologies serve the flow measurement market through both customized and standard flow instrumentation solutions.

Industries today face accelerating demands to contain costs, reduce product variability, and meet ever-changing safety, regulatory and sustainability requirements. To address these challenges, customers must reap more value from every component in their systems. This system-wide scrutiny has heightened the focus on flow instrumentation in industrial process, manufacturing, commercial fluid, building automation, and precision engineering applications where flow measurement and control are critical.

An industry leader in both mechanical and electrical flow metering technologies, the Company offers one of the broadest flow measurement, control and communication portfolios in the market. The portfolio carries respected brand names including Recordall®, E-Series®, ORION, Hedland®, Dynasonics®, Blancett®, and Research Control®, and includes eight of the ten major flow meter technologies. Customers rely on the Company for application-specific solutions that deliver accurate, timely and dependable flow data and control essential for product quality, cost control, safer operations, regulatory compliance, and more sustainable operations.

## Business Trends

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

The Company sells its technology solutions to meet customer requirements. Since the technology products have comparable margins, any change in the mix between AMR, AMI or AMA is not expected to have a significant impact on the Company's net sales related to meter reading technology.

There are approximately 52,000 water utilities in the United States and the Company estimates that less than 53% of them have converted to a radio solutions technology. With the BEACON AMA managed solution and the wide breadth of water meters, the Company believes it is well-positioned to meet customers' future needs.

In the global market, companies need to comply with increasing regulations requiring companies to better manage critical resources, monitor their use of hazardous materials, and reduce exhaust gases. Some customers measure fluids to identify leaks and/or misappropriation for cost control or add measurement points to help automate manufacturing. Other

14

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## Table of Contents

customers employ measurement to comply with government mandates and laws. The Company provides technology to measure water, hydrocarbon-based fluids, chemicals, gases and steams.

Flow measurements are critical to provide a baseline and quantify reductions as customers attempt to reduce consumption. Once water usage is better understood, a strategy for water-use reduction can be developed with specific water-reduction initiatives targeted to those areas where water reduction is most viable. With the Company's technology, customers have found costly leaks, pinpointed equipment in need of repair, and identified areas for process improvements.

## Acquisition

On August 17, 2015, the Company's wholly-owned subsidiary, National Meter and Automation, Inc. ("National Meter"), acquired the assets of United Utilities, Inc. of Smyrna, Tennessee, which was one of the Company's distributors serving Tennessee and Georgia. National Meter will do business in those and additional areas as "United Utilities."

The total purchase consideration for the United Utilities assets was \$3.3 million, which included \$0.4 million in cash and settlement of \$2.9 million of pre-existing Company receivables. The Company's allocation of the purchase price at December 31, 2015 included \$0.8 million of receivables, \$0.4 million of inventory, \$0.1 million of property, plant and equipment, \$1.7 million of intangibles and \$0.3 million of goodwill. As of June 30, 2016, the Company had not completed its analysis for estimating the fair value of the assets acquired and liabilities assumed. This acquisition is further described in Note 5 "Acquisitions" in the Notes to Consolidated Financial Statements.

## Revenue and Product Mix

As the industry continues to evolve, the Company has been vigilant in anticipating and exceeding customer expectations. In 2011, the Company introduced AMA as a hardware and software solution for water and gas utilities, and then in early 2014 launched its new BEACON AMA system as a managed solution which it believes will help maintain the Company's position as a market leader. Over the past two years, sales of BEACON AMA has continued to increase, with large cities and private water utilities selecting BEACON AMA and the Company's industry-leading water meters.

The Company continues to seek opportunities for additional revenue enhancement. For instance, the Company is periodically asked to oversee and perform field installation of its products for certain customers. The Company assumes the role of general contractor, hiring installation subcontractors and supervising their work. The Company also supports its product and technology sales with the sale of extended service programs that provide additional services beyond the standard warranty. In recent years, the Company has sold ORION radio technology to natural gas utilities for installation on their gas meters. And most recently, the introduction of the BEACON AMA system opens the door to "software as a service" revenues. With the exception of a large sale of gas radios to one particular customer several years ago, revenues from such products and services are not yet significant and the Company is uncertain of the potential growth achievable for such products and services in future periods.

## Results of Operations - Three Months Ended June 30, 2016

The Company's net sales for the three months ended June 30, 2016 increased \$4.9 million, or 5.0%, to \$103.8 million compared to \$98.9 million during the same period in 2015. This was the net result of higher sales of municipal water products, offset somewhat by lower sales of flow instrumentation products.

Municipal water sales represented 77.1% of sales in the second quarter of 2016 compared to 75.5% in the second quarter of 2015. These sales increased \$5.4 million, or 7.2%, to \$80.0 million in the second quarter of 2016 from



\$74.6 million in the second quarter of 2015. The increase was the result of higher sales of both residential and commercial water meters and related technologies. Overall residential sales increased 3.5% on higher volumes and modestly higher prices while commercial sales increased 29.1% due to higher volumes of product sold.

Flow instrumentation products represented 22.9% of sales for the three months ended June 30, 2016 compared to 24.5% in the same period in 2015. These sales decreased \$0.5 million, or 2.1%, to \$23.8 million from \$24.3 million in the same period last year. Sales of these products continue to be impacted by the slow growth economy and overall general softness in the markets served.

Gross margin as a percentage of sales was 37.9% in the second quarter of 2016 compared to 35.5% in the second quarter of 2015. Higher volumes of product produced, modestly higher prices and lower material costs, particularly brass

Table of Contents

castings, contributed to the higher percentage, offset somewhat by product mix (lower volumes of higher margin flow instrumentation products).

Selling, engineering and administration expenses for the three months ended June 30, 2016 increased \$1.5 million, or 6.5%, to \$24.5 million from \$23.0 million in the same period in 2015. Approximately \$0.7 million are costs associated with the Company's exploration of various options to enhance shareholder value and amounts associated with an early retirement program offered to certain flow instrumentation employees. The remainder of the increase was due to higher employee incentive costs and normal inflationary impacts.

Operating earnings for the second quarter of 2016 increased \$2.7 million, or 22.1%, to \$14.9 million compared to \$12.2 million in the same period in 2015 as the result of the higher overall sales and increased gross margins, offset somewhat by higher selling, engineering and administration expenses.

The provision for income taxes as a percentage of earnings before income taxes for the second quarter of 2016 was 36.0% compared to 33.4% in the second quarter of 2015, which included the reversal of reserves no longer required due to the settlement of tax audits. Interim provisions are tied to an estimate of the overall annual rate that can vary due to state taxes, the relationship of foreign and domestic earnings and production credits available.

As a result of the above mentioned items, net earnings for the three months ended June 30, 2016 were \$9.4 million, or \$0.65 per diluted share, compared to \$7.9 million, or \$0.55 per diluted share, for the same period in 2015.

Results of Operations - Six Months Ended June 30, 2016

The Company's net sales for the six months ended June 30, 2016 increased \$21.8 million, or 11.9%, to \$204.4 million compared to \$182.6 million during the same period in 2015. This was the net result of higher sales of municipal water products, offset somewhat by lower sales of flow instrumentation products.

Municipal water sales represented 77.0% of sales for the first six months of 2016 compared to 72.9% for the first six months of 2015. These sales increased \$24.2 million, or 18.2%, to \$157.3 million from \$133.1 million in 2015. The increase was the result of higher sales of both residential and commercial water meters and related technologies. Overall residential sales for the first six months of 2016 increased 14.3% on higher volumes and modestly higher pricing while commercial sales increased 42.8% due to higher volumes of product sold.

Flow instrumentation products represented 23.0% of sales for the six months ended June 30, 2016 compared to 27.1% in the same period in 2015. These sales decreased \$2.4 million, or 4.8%, to \$47.1 million for the first six months in 2016 to \$49.5 million in the same period last year. Sales of these products are being impacted by the slow growth economy and overall general softness in the markets served. In addition, lower sales of meters to oil and gas customers and the loss of two key customers contributed to the decrease.

Gross margin as a percentage of sales was 38.4% for the first six months of 2016 compared to 35.7% in the same period in 2015. This percentage was favorably impacted by the higher volumes of product sold, modestly higher pricing and lower material costs, particularly brass, offset somewhat by product mix (lower volumes of higher margin flow instrumentation products).

Selling, engineering and administration expenses for the six months ended June 30, 2016 increased \$4.7 million, or 10.2%, to \$50.7 million from \$46.0 million in the same period in 2015. The increase was due to higher employee incentive costs and software amortization expenses. Also, approximately \$0.9 million of the increase were costs associated with the Company's exploration of various options to enhance shareholder value and amounts associated with an early retirement program offered to certain flow instrumentation employees.

Operating earnings for the first six months of 2016 increased \$8.5 million, or 44.3%, to \$27.7 million compared to \$19.2 million in the same period in 2015 as the result of the higher overall sales and increased gross margins, offset somewhat by higher selling, engineering and administration expenses.

The provision for income taxes as a percentage of earnings before income taxes for the first six months of 2016 was 36.1% compared to 34.8% for the same period in 2015, which included the reversal of reserves no longer required due to the settlement of tax audits. Interim provisions are tied to an estimate of the overall annual rate that can vary due to state taxes, the relationship of foreign and domestic earnings and production credits available.

Table of Contents

As a result of the above mentioned items, net earnings for the six months ended June 30, 2016 were \$17.4 million, or \$1.20 per diluted share, compared to \$12.1 million, or \$0.84 per diluted share, for the same period in 2015.

Liquidity and Capital Resources

The main sources of liquidity for the Company are cash from operations and borrowing capacity. Cash provided by operations was \$27.7 million for the first six months of 2016 compared to \$19.2 million in the first six months of 2015. The increase was primarily the net effect of higher earnings and higher liabilities other than debt, offset by increases in receivables.

Receivables increased from \$56.6 million at December 31, 2015 to \$61.3 million at June 30, 2016. The increase was due to higher sales in the second quarter of 2016 than the fourth quarter of 2015. Generally, sales are lower in the fourth quarter of the year, resulting in lower receivable balances at year end. The Company believes its net receivables balance is fully collectible.

Inventories increased \$2.1 million to \$80.7 million at June 30, 2016 from \$78.6 million at December 31, 2015 due principally to delays in certain anticipated sales.

Net property, plant and equipment at June 30, 2016 decreased slightly to \$90.8 million from \$90.9 million at December 31, 2015. This was the net effect of \$5.5 million of capital expenditures in the first half of 2016, offset by depreciation expense.

Intangible assets decreased to \$54.3 million at June 30, 2016 from \$57.3 million at December 31, 2015 due to normal amortization expense.

Short-term debt at June 30, 2016 decreased to \$53.6 million from \$71.4 million at December 31, 2015 as cash generated from operations was used to reduce borrowings.

Payables of \$22.2 million at June 30, 2016 increased \$3.0 million from \$19.2 million at December 31, 2015. These balances are affected by the timing of purchases and payments.

Accrued compensation and employee benefits increased to \$11.1 million at June 30, 2016 from \$9.7 million at December 31, 2015 due primarily to increased employee incentive compensation earned in the first half of 2016.

Income and other taxes increased to \$3.5 million from \$1.2 million at December 31, 2015. The change was the net impact of higher pretax earnings and the timing of actual tax payments.

The overall increase in total shareholders' equity from \$232.3 million at December 31, 2015 to \$245.9 million at June 30, 2016 was the net effect of net earnings and stock options exercised, offset by dividends paid.

The Company's financial condition remains strong. In May 2014, the Company amended its May 2012 credit agreement with its primary lender to a three-year \$105.0 million line of credit that supports commercial paper (up to \$70.0 million) and includes \$5.0 million of a Euro line of credit, which it expects to renew. While the facility is unsecured, there are a number of financial covenants with which the Company must comply, and the Company was in compliance as of June 30, 2016. The Company believes that its operating cash flows, available borrowing capacity, and its ability to raise capital provide adequate resources to fund ongoing operating requirements, future capital expenditures and the development of new products. The Company continues to take advantage of its local commercial paper market and carefully monitors the current borrowing market. The Company had \$59.1 million of unused credit

lines available at June 30, 2016.

#### Other Matters

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

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

17

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Table of Contents

whole. This belief is based on the Company's assessment of its limited past involvement with these landfill sites as well as the substantial involvement of and government focus on other named third parties with these landfill sites. However, due to the inherent uncertainties of such proceedings, the Company cannot predict the ultimate outcome of any of these matters. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2015 and the first half of 2016 were not material.

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

See the "Special Note Regarding Forward Looking Statements" at the front of this Quarterly Report on Form 10-Q and Part I, Item 1A "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 for a discussion of risks and uncertainties that could impact the Company's financial performance and results of operations.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company's off-balance sheet arrangements and contractual obligations are discussed in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the headings "Off-Balance Sheet Arrangements" and "Contractual Obligations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 and have not materially changed since that report was filed unless otherwise indicated in this Form 10-Q.

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, 2015 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 June 30, 2016. Based upon their evaluation of these disclosure controls and procedures, the Company's Chairman, President and Chief Executive Officer and the Company's Senior Vice President

- Finance, Chief Financial Officer and Treasurer concluded that, as of the date of such evaluation, the Company's disclosure controls and procedures were effective.

#### Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2016 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

Part II – Other Information

Item 6 Exhibits

Exhibit No. Description

31.1 Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certification of Periodic Financial Report by the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter and six months ended June 30, 2016 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Condensed Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Condensed Statements of Cash Flows, (v) Notes to Unaudited Consolidated Condensed Financial Statements, tagged as blocks of text and (vi) document and entity information.



Table of Contents

SIGNATURES

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

BADGER METER, INC.

Dated: July 22, 2016 By /s/ Richard A. Meeusen  
Richard A. Meeusen  
Chairman, President and Chief Executive Officer

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

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

Table of Contents

BADGER METER, INC.

Quarterly Report on Form 10-Q for the Period Ended June 30, 2016

Exhibit Index

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21