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

Form 10-Q

(Mark One)

- ☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

OR

- ☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number: 001-08762



ITERIS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

1700 Carnegie Avenue, Suite 100

Santa Ana, California

(Address of principal executive office)

95-2588496

(I.R.S. Employer
Identification No.)

92705

(Zip Code)

(949) 270-9400

(Registrant's telephone number, including area code)

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, as amended (the "Exchange Act"), 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 (§232.405 of this chapter) 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 ☐

Smaller reporting company ☒

(Do not check if a smaller reporting company)

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

As of October 26, 2009, there were 34,280,756 shares of common stock outstanding.

ITERIS, INC.
Quarterly Report on Form 10-Q
For the Three and Six Months Ended September 30, 2009

Table of Contents

PART I.	FINANCIAL INFORMATION	3
ITEM 1.	FINANCIAL STATEMENTS	3
	UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS AT SEPTEMBER 30, 2009 AND MARCH 31, 2009	3
	UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2009 AND 2008	4
	UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE SIX MONTHS ENDED SEPTEMBER 30, 2009 AND 2008	5
	NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS	6
ITEM 2.	MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	16
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	26
ITEM 4.	CONTROLS AND PROCEDURES	26
PART II.	OTHER INFORMATION	27
ITEM 1.	LEGAL PROCEEDINGS	27
ITEM 1A.	RISK FACTORS	27
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	35
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	35
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	35
ITEM 5.	OTHER INFORMATION	36
ITEM 6.	EXHIBITS	36

Unless otherwise indicated in this report, the “Company,” “we,” “us” and “our” refer to Iteris, Inc. and our wholly-owned subsidiary, Iteris Europe GmbH.

AutoVue[®], Iteris[®], Vantage[®], VersiCam[™], EdgeConnect[™], RZ4 Advanced[™] and Safety Direct[™] are among the trademarks of Iteris, Inc. Any other trademarks or trade names mentioned herein are the property of their respective owners.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

Iteris, Inc.
Unaudited Condensed Consolidated Balance Sheets
(In thousands, except par value amounts)

	September 30, 2009	March 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 9,185	\$ 6,372
Trade accounts receivable	10,554	12,448
Costs in excess of billings on uncompleted contracts	3,926	4,217
Inventories	3,702	5,681
Deferred income taxes	3,790	4,241
Prepaid expenses and other current assets	401	272
Total current assets	31,558	33,231
Property and equipment, net	2,864	3,244
Deferred income taxes	11,505	11,505
Intangible assets, net	525	110
Goodwill	27,791	27,774
Other assets	199	202
Total assets	<u>\$ 74,442</u>	<u>\$ 76,066</u>
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	\$ 2,642	\$ 4,228
Accrued payroll and related expenses	2,765	3,188
Accrued liabilities	1,884	1,662
Billings in excess of costs and estimated earnings on uncompleted contracts	1,362	1,534
Current portion of long-term debt	2,324	2,019
Total current liabilities	10,977	12,631
Deferred rent	1,541	1,686
Unrecognized tax benefits	1,117	1,117
Other non-current liabilities	112	—
Long-term debt	4,384	5,274
Total liabilities	18,131	20,708
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.10 par value, 70,000 shares authorized, 34,281 and 34,205 shares issued and outstanding at September 30, 2009 and March 31, 2009, respectively	3,428	3,420
Additional paid-in capital	137,266	136,997
Common stock held in trust	(31)	(31)
Accumulated deficit	(84,385)	(85,025)
Accumulated other comprehensive income (loss)	33	(3)
Total stockholders' equity	56,311	55,358
Total liabilities and stockholders' equity	<u>\$ 74,442</u>	<u>\$ 76,066</u>

See accompanying notes.

Iteris, Inc.
Unaudited Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Net sales and contract revenues:				
Net sales	\$ 8,462	\$ 11,078	\$ 15,395	\$ 21,604
Contract revenues	6,403	7,988	14,104	14,904
Total net sales and contract revenues	14,865	19,066	29,499	36,508
Costs of net sales and contract revenues:				
Cost of net sales(a)	4,412	5,886	8,255	11,153
Cost of contract revenues(a)	3,883	5,305	9,092	9,728
Gross profit	6,570	7,875	12,152	15,627
Operating expenses:				
Selling, general and administrative(a)	4,527	4,653	8,780	9,808
Research and development(a)	884	1,122	1,848	2,332
Amortization of intangible assets	42	36	86	73
Total operating expenses	5,453	5,811	10,714	12,213
Operating income	1,117	2,064	1,438	3,414
Non-operating income (expense):				
Other income (expense), net	(2)	22	17	27
Interest expense, net	(71)	(198)	(157)	(396)
Income before income taxes	1,044	1,888	1,298	3,045
Provision for income taxes	(501)	(821)	(611)	(1,312)
Net income	\$ 543	\$ 1,067	\$ 687	\$ 1,733
Earnings per share:				
Basic	\$ 0.02	\$ 0.03	\$ 0.02	\$ 0.05
Diluted	\$ 0.02	\$ 0.03	\$ 0.02	\$ 0.05
Weighted average shares outstanding:				
Basic	34,254	33,948	34,223	33,783
Diluted	34,435	34,959	34,411	34,949

(a) Includes stock-based compensation expense as follows:

Cost of net sales	\$ 2	\$ 3	\$ 4	\$ 5
Cost of contract revenues	10	10	20	20
Selling, general and administrative expense	79	76	150	153
Research and development expense	7	5	13	10
Total stock-based compensation expense	\$ 98	\$ 94	\$ 187	\$ 188

See accompanying notes.

Iteris, Inc.
Unaudited Condensed Consolidated Statements of Cash Flows
(In thousands)

	Six Months Ended September 30,	
	2009	2008
Cash flows from operating activities		
Net income	\$ 687	\$ 1,733
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property and equipment	499	498
Stock-based compensation	187	188
Amortization of intangible assets	86	73
Amortization of debt discounts	—	82
Amortization of deferred financing costs	—	54
Change in deferred tax assets	451	1,027
Changes in operating assets and liabilities:		
Accounts receivable	1,908	(1,526)
Net costs and estimated earnings in excess of billings	119	1,289
Inventories	1,979	(368)
Prepaid expenses and other assets	(124)	(55)
Accounts payable and accrued expenses	(2,126)	389
Net cash provided by operating activities	3,666	3,384
Cash flows from investing activities		
Purchases of property and equipment	(116)	(486)
Cash paid for acquisition	(300)	—
Net cash used in investing activities	(416)	(486)
Cash flows from financing activities		
Borrowings on long-term debt	750	—
Payments on long-term debt	(1,335)	(232)
Proceeds from stock option exercises	90	684
Net cash provided by (used in) financing activities	(495)	452
Effect of exchange rate changes on cash	58	—
Increase in cash and cash equivalents	2,813	3,350
Cash and cash equivalents at beginning of period	6,372	421
Cash and cash equivalents at end of period	<u>\$ 9,185</u>	<u>\$ 3,771</u>
Supplemental disclosure of non-cash investing and financing activities:		
Liabilities incurred for business combination	\$ 218	\$ —
Fair value of common stock issued in settlement of liabilities	—	427

See accompanying notes.

Iteris, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2009

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Iteris, Inc. (including our subsidiary, referred to collectively in these consolidated financial statements as “Iteris,” the “Company,” “we,” “our” and “us”) is a leader in the traffic management market focused on the development and application of advanced technologies that reduce traffic congestion, minimize the environmental impact of traffic congestion and improve the safety of surface transportation systems infrastructure. By combining outdoor image processing, traffic engineering and information technology, we offer a broad range of Intelligent Transportation Systems (“ITS”) and driver safety solutions. Iteris was originally incorporated in Delaware in 1987.

Basis of Presentation

Our unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and with the instructions to Securities and Exchange Commission (“SEC”) Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of Iteris as of September 30, 2009, the consolidated results of operations for the three and six months ended September 30, 2009 and 2008 and the consolidated cash flows for the six months ended September 30, 2009 and 2008. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. The results of operations for the three and six months ended September 30, 2009 are not necessarily indicative of those to be expected for future quarterly periods or the entire year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended March 31, 2009 (“fiscal 2009”), which was filed with the SEC on June 12, 2009.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made in the preparation of the consolidated financial statements include the allowance for doubtful accounts, projections of taxable income used to assess realizability of deferred tax assets, inventory and warranty reserves, costs to complete long-term contracts, overhead rates used in cost-plus contracts, contract reserves and estimates of future cash flows used to assess the recoverability of long-lived assets, the valuation of debt and equity instruments and the realization of goodwill.

Revenue Recognition

Product revenues and related costs of sales are recognized upon the transfer of title, which generally occurs upon shipment or, if required, upon acceptance by the customer, provided that we believe collectibility of the net sales amount is probable. Accordingly, at the date revenue is recognized, the significant uncertainties concerning the sale have been resolved.

Contract revenues are derived primarily from long-term contracts with governmental agencies. Contract revenues include costs incurred plus a portion of estimated fees or profits determined on the percentage of completion method of accounting based on the relationship of costs incurred to date to total estimated costs. Any anticipated losses on contracts are charged to earnings when identified. Changes in job performance and estimated profitability, including those arising from contract penalty provisions and final contract settlements, may result in revisions to costs and revenues and are recognized in the period in which the revisions are determined. Profit incentives are included in revenue when their realization is reasonably assured.

We also derive revenue from the provision of specific non-recurring contract engineering services and royalties. Non-recurring contract engineering revenues are recognized in the period in which the related services are performed. Royalty revenues are recorded in the period in which the royalty is earned based on unit sales of certain of our products. Non-recurring contract engineering and royalty revenues are included in net sales in the accompanying condensed consolidated statements of operations and totaled \$191,000 and \$439,000 for the three and six months ended September 30, 2009, respectively, and \$284,000 and \$658,000 for the three and six months ended September 30, 2008, respectively.

Concentration of Credit Risk

Financial instruments that potentially subject us to a concentration of credit risk consist principally of cash and cash equivalents and trade accounts receivable.

Cash and cash equivalents consist primarily of demand deposits and money market funds maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with high credit quality financial institutions and therefore have minimal credit risk.

Accounts receivable are primarily derived from revenues earned from customers located throughout North America and Europe. We generally do not require collateral or other security from customers. Collectibility of receivable balances is estimated through review of invoices outstanding greater than a certain period of time and ongoing credit evaluations of our customers' financial condition. Reserves are maintained for potential credit losses, and such losses have historically been within management's expectations.

Fair Values of Financial Instruments

The fair value of cash and cash equivalents, receivables, accounts payable and accrued expenses approximate carrying value because of the short period of time to maturity. The fair value of line of credit agreements, long-term debt and convertible debentures approximate carrying value because the related effective rates of interest approximate current market rates available to us for debt with similar terms and similar remaining maturities. The estimated fair value of certain of our outstanding warrants is determined using Level 3 Inputs (see Notes 6 and 7).

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Property and Equipment

Property and equipment are recorded at cost and are generally depreciated using the straight-line method over the estimated useful life ranging from three to eight years. Leasehold improvements are depreciated over the term of the related lease or the estimated useful life of the improvement, whichever is shorter.

Goodwill and Long-Lived Assets

Goodwill is tested for impairment on an annual basis in our fourth fiscal quarter or more frequently if indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of our reporting units with each respective reporting unit's carrying amount, including goodwill. We determine the fair value of reporting units using the income approach. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, the second step of the goodwill impairment test is performed to determine the amount of any impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. We performed annual impairment assessments of the carrying value of goodwill for each of the fiscal years ended March 31, 2009, 2008 and 2007. Based on these assessments, we determined that no impairment at that time was indicated as the estimated fair value of each of our reporting units exceeded its respective carrying value. We monitor the indicators for goodwill impairment testing between annual tests. Certain adverse business conditions impacting one or more of our reporting units would cause us to test goodwill for impairment. No such events occurred during the three and six months ended September 30, 2009.

We evaluate long-lived assets for impairment when indicators of impairment are present. Reviews are performed to determine whether the carrying value of assets is impaired, based on a comparison to undiscounted expected future cash flows. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using discounted expected future cash flows and a discount rate based upon our weighted average cost of capital adjusted for risks associated with the related operations. Impairment is based on the excess of the carrying amount over the fair value of those assets.

Income Taxes

We utilize the liability method of accounting for income taxes, whereby deferred taxes are determined based on the temporary differences between the financial statement and tax bases of assets and liabilities using enacted tax rates. A valuation allowance is recorded when it is more likely than not that all or a portion of the deferred tax assets will not be realized.

Stock-Based Compensation

We record stock-based compensation expense in the statement of operations as an expense, based on the grant date fair values of our stock-based awards, whereby such fair values are amortized over the requisite service period. The fair value of our common stock option awards is estimated on the grant date using the Black-Scholes-Merton (“BSM”) option-pricing formula, which considers, among other factors, the expected life of the award and the expected volatility of our stock price.

Research and Development Expenditures

Research and development expenditures are charged to expense in the period in which they are incurred.

Shipping and Handling Costs

Shipping and handling costs are included in cost of sales in the period during which products ship.

Sales Taxes

Sales taxes are presented on a net basis (excluded from net sales and contract revenues) in the unaudited condensed consolidated statements of operations.

Warranty

We generally provide a one to three year warranty from the original invoice date on all products, materials and workmanship. Products sold to certain original equipment manufacturer (“OEM”) customers sometimes carry longer warranties. Defective products will be either repaired or replaced, generally at our option, upon meeting certain criteria. We accrue a provision for the estimated costs that may be incurred for product warranties relating to a product as a component of cost of sales at the time revenue for that product is recognized. The accrued warranty provision is included within accrued liabilities in the accompanying condensed consolidated balance sheets.

Repair and Maintenance Costs

We incur repair and maintenance costs in the normal course of business. Should the activity result in a permanent improvement to one of our leased facilities, the cost is capitalized as a leasehold improvement and amortized over its useful life or the remainder of the lease period, whichever is shorter. Non-permanent repair and maintenance costs are charged to expense as incurred.

Other Comprehensive Income

The only component of accumulated other comprehensive income is foreign currency translation adjustments.

Recent Accounting Pronouncements

In August 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2009-05, *Measuring Liabilities at Fair Value* (“ASU 2009-05”). ASU 2009-05 amends Topic 820 of the FASB Accounting Standards Codification (“ASC”) by providing additional guidance clarifying the measurement of liabilities at fair value. The amendments prescribed by ASU 2009-05 will be effective for our fiscal quarter ending December 31, 2009 and are not expected to have a material impact on our consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-13, *Multiple-Deliverable Revenue Arrangements — a consensus of the FASB Emerging Issues Task Force* (“ASU 2009-13”), which amends the existing multiple-element revenue arrangements guidance currently included in ASC 605-25, *Revenue Recognition — Multiple Element Arrangements*. ASU 2009-13 provides for two significant changes to the existing multiple-element revenue arrangements guidance. The first relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables. The amendments prescribed by ASU 2009-13 will be effective for our fiscal year beginning April 1, 2011. Early adoption is permitted provided that an entity retroactively applies the guidance to the beginning of the fiscal year of adoption. We are currently evaluating the impact that the adoption of this ASU will have on our consolidated financial statements.

[Table of Contents](#)

In October 2009, the FASB issued ASU No. 2009-14, *Certain Revenue Arrangements That Include Software Elements — a consensus of the FASB Emerging Issues Task Force* (“ASU 2009-14”), which amends and modifies the scope of ASC 985-605, *Software — Revenue Recognition*, such that many tangible products that rely on software and other related transactions will fall outside its scope. The amendments prescribed by ASU 2009-14 will be effective for our fiscal year beginning April 1, 2011. Early adoption is permitted provided that an entity retroactively applies the guidance to the beginning of the fiscal year of adoption. Additionally, adoption must occur in conjunction with the adoption of the amendments within ASU 2009-13 (described above). We are currently evaluating the impact that the adoption of this ASU will have on our consolidated financial statements.

2. Supplemental Financial Information

Inventories

The following table presents details of our inventories:

	September 30, 2009	March 31, 2009
	(In thousands)	
Materials and supplies	\$ 3,013	\$ 4,820
Work in process	123	198
Finished goods	566	663
	<u>\$ 3,702</u>	<u>\$ 5,681</u>

Intangible Assets

The following table presents details of our intangible assets:

	September 30, 2009		March 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Intangible assets subject to amortization:				
Developed technology	\$ 996	\$ (545)	\$ 495	\$ (482)
Patents	317	(243)	317	(220)
Total	<u>\$ 1,313</u>	<u>\$ (788)</u>	<u>\$ 812</u>	<u>\$ (702)</u>

Amortization expense for intangible assets subject to amortization was \$42,000 and \$86,000 for the three and six months ended September 30, 2009 respectively, and \$36,000 and \$73,000 for the three and six months ended September 30, 2008, respectively. As of September 30, 2009, future estimated amortization expense is as follows:

Fiscal Year Ending March 31:	
(In thousands)	
Remainder of 2010	\$ 73
2011	152
2012	100
2013	100
2014	100
	<u>\$ 525</u>

Goodwill

The following table presents the activity related to the carrying value of our goodwill by reportable segment for the six months ended September 30, 2009:

	Roadway Sensors	Vehicle Sensors	Transportation Systems	Total
	(In thousands)			
Beginning balance	\$ 8,197	\$ 4,671	\$ 14,906	\$ 27,774
Goodwill recorded in connection with Hamilton Signal acquisition (Note 3)	17	—	—	17
Ending balance	<u>\$ 8,214</u>	<u>\$ 4,671</u>	<u>\$ 14,906</u>	<u>\$ 27,791</u>

Warranty Reserve Activity

The following table presents activity related to the warranty reserve:

	Six Months Ended September 30,	
	2009	2008
	(In thousands)	
Balance at beginning of period	\$ 582	\$ 494
Additions charged to cost of sales	102	184
Warranty claims	(94)	(121)
Balance at end of period	<u>\$ 590</u>	<u>\$ 557</u>

Comprehensive Income

The following table presents the components of comprehensive income:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands)			
Net income	\$ 543	\$ 1,067	\$ 687	\$ 1,733
Other comprehensive income (loss):				
Foreign currency translation adjustments	14	(27)	36	(28)
Total comprehensive income	<u>\$ 557</u>	<u>\$ 1,040</u>	<u>\$ 723</u>	<u>\$ 1,705</u>

Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
(In thousands, except per share amounts)				
Numerator:				
Net Income	\$ 543	\$ 1,067	\$ 687	\$ 1,733
Denominator:				
Weighted average common shares used in basic computation	34,254	33,948	34,223	33,783
Dilutive stock options	181	1,006	188	1,160
Dilutive warrants	—	5	—	6
Weighted average common shares used in diluted computation	34,435	34,959	34,411	34,949
Earnings per share:				
Basic	\$ 0.02	\$ 0.03	\$ 0.02	\$ 0.05
Diluted	\$ 0.02	\$ 0.03	\$ 0.02	\$ 0.05

The following instruments were excluded from the computation of diluted earnings per share as their effect would have been anti-dilutive:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
(In thousands)				
Stock options	2,451	1,033	2,517	775
Warrants	336	1,150	414	1,150
Convertible debentures	—	2,147	—	2,147

3. Business Combination

On April 3, 2009 (the “Closing”), we completed the acquisition of certain assets of Hamilton Signal, Inc., a privately-held developer of video processing algorithms enabling state and local governments to conduct real-time analysis on fixed and Pan-Tilt-Zoom camera feeds. The total purchase consideration was approximately \$518,000, for which we paid \$300,000 in cash upon execution of the purchase agreement, and for which, pursuant to the purchase agreement, we are scheduled to pay an additional (i) \$106,000 on the first anniversary of the Closing and (ii) approximately \$112,000 on the second anniversary of the Closing. Pursuant to the purchase agreement, the seller became an employee of Iteris and is eligible to receive compensation based on future net sales of certain products during the three-year period ending March 31, 2012, subject to continued employment and other limitations.

We have accounted for this acquisition as a business combination. We calculated the fair value of the assets acquired to allocate the purchase price, which is summarized as follows (in thousands):

Purchased intangible assets	\$ 501
Goodwill	17
	<u>\$ 518</u>

The purchased developed technology was determined to have an estimated useful life of five years. Our primary reasons for the acquisition were to expand our product portfolio in the traffic management market and to incorporate enhanced functionality into and complement our Roadway Sensors technologies.

[Table of Contents](#)

Our unaudited condensed consolidated financial statements for the three and six months ended September 30, 2009 include the results of operations of Hamilton Signal commencing as of the Closing. Disclosures required for material business combinations have been limited due to the immateriality of the acquisition of Hamilton Signal to our consolidated financial statements. No supplemental pro forma information is presented for the acquisition due to the immaterial effect of the acquisition on our results of operations.

4. Revolving Line of Credit and Long-Term Debt

Revolving Line of Credit

In October 2008, we entered into a \$19.5 million credit facility with California Bank & Trust, which provides for a two-year revolving line of credit with borrowings of up to \$12.0 million and a \$7.5 million 48-month term note (discussed below). Interest on borrowed amounts under the revolving line of credit are payable monthly at a rate equal to the current stated prime rate up to the current stated prime rate plus 0.50%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility (3.75% at September 30, 2009). We are obligated to pay an unused line fee of 0.25% per annum applied to the average unused portion of the revolving line of credit during the preceding month. The revolving line of credit does not contain any early termination fees and is secured by substantially all of our assets. As of September 30, 2009, no amounts were outstanding under the revolving line of credit portion of the facility.

Long-Term Debt

Our long-term debt consists of the following:

	September 30, 2009	March 31, 2009
	(In thousands)	
Bank term note	\$ 6,708	\$ 6,543
Convertible debentures, net	—	750
	6,708	7,293
Less current portion	(2,324)	(2,019)
	<u>\$ 4,384</u>	<u>\$ 5,274</u>

Convertible Debentures, Net. In May 2009, we retired the remaining \$750,000 of convertible debentures that were outstanding as of March 31, 2009, which retirement was financed under our bank term note.

Bank Term Note. Under our current credit facility, which we entered into in October 2008, we may borrow up to \$7.5 million in the form of a 48-month term note. Principal payments under this term note are required to be repaid in 48 monthly installments commencing on June 1, 2009. Additionally, beginning on November 1, 2009, and on November 1 of each year thereafter, we are required to pay additional principal of up to \$500,000, calculated based on certain financial measures, as further defined in the agreement. As of September 30, 2009, this additional \$500,000 is included in the current portion of the term note. Interest on the term note is payable monthly at a rate equal to the current stated prime rate plus 0.50% up to the current stated prime rate plus 1.00%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility (4.25% at September 30, 2009). The term note contains no early termination fees and, along with the revolving line of credit under the same credit agreement, is secured by substantially all of our assets.

5. Commitments and Contingencies

Litigation and Other Contingencies

From time to time, we have been involved in litigation relating to claims arising out of our operations in the normal course of business. We currently are not a party to any legal proceedings, the adverse outcome of which, in management's opinion, individually or in the aggregate, would have a material adverse effect on our consolidated results of operations, financial position or cash flows.

Furthermore, from time to time, we have experienced unforeseen developments in contingencies related to our former subsidiaries. For example, we have been the subject of a number of routine tax audits for time periods and jurisdictions related to the businesses of our former subsidiaries, some of which are still in process. Although the development and ultimate outcome of these and other unforeseen matters cannot be predicted with any certainty, our management does not believe that we are presently involved in any matters related to our former subsidiaries that would have a material adverse effect on our consolidated results of operations, financial position or cash flows.

Operating Lease

We previously subleased office space to MAXxess Systems, Inc. ("MAXxess"), one of our former subsidiaries that we sold in September 2003 and is currently owned by an investor group that includes two of our directors, one of whom is the Chief Executive Officer of MAXxess. The sublease terminated in September 2007, at which time MAXxess owed us an aggregate of \$274,000 related to this sublease and certain related ancillary services that we provided to MAXxess. We have previously fully reserved for amounts owed to us by MAXxess under the terms of this sublease. In August 2009, MAXxess executed a promissory note in favor of Iteris for \$274,000. The promissory note bears interest at a rate of 6% per annum, compounded annually, with accrued interest to be paid annually on the first business day of each calendar year. Payments under the note may be made in bona fide services rendered by MAXxess to Iteris to the extent such services and amounts are pre-approved in writing by us. All amounts outstanding under the note will become due and payable on the earliest of August 10, 2014, a change of control in MAXxess or a financing by MAXxess resulting in gross proceeds of at least \$10 million. All amounts due from MAXxess continue to remain fully reserved.

6. Warrants

The following table summarizes information regarding outstanding warrants to purchase our common stock as of September 30, 2009:

Exercise Price	Warrants Outstanding (In thousands)	Weighted Average Remaining Contractual Life (Years)
\$ 1.42	15	3.9
3.25	246	1.4
5.00	75	0.8
	<u>336</u>	<u>1.4</u>

In May 2009, outstanding warrants with a weighted average per share exercise price of \$3.93 to purchase approximately 674,000 shares of our common stock, which were associated with our convertible debentures (see Note 4), expired unexercised. In July 2009, outstanding warrants with a per share exercise price of \$5.26 to purchase approximately 155,000 shares of our common stock expired unexercised.

In connection with our adoption of certain provisions within ASC Topic 815, *Derivatives and Hedging*, which became effective for us on April 1, 2009, we determined that certain outstanding warrants to purchase shares of our common stock contain provisions that provide for a possible future adjustment to either the exercise price and/or number of shares to be issued upon exercise. As such, beginning April 1, 2009, we began recognizing these warrants as liabilities at their respective estimated fair values on each reporting date. The cumulative effect of the change in accounting for these warrants of \$47,000 was recognized as an adjustment to the opening balance of accumulated deficit at April 1, 2009. The amounts recognized in the consolidated balance sheet as a result of our adoption on April 1, 2009 were determined based on the amounts that would have been recognized if this accounting treatment had been applied from the issuance date of the warrants. At September 30, 2009, the estimated fair value of the warrants, which is included in accrued liabilities in the accompanying unaudited condensed consolidated balance sheet, was \$37,000. The change in the estimated fair value of the warrants for the three and six months ended September 30, 2009 is included in other income in the accompanying unaudited condensed consolidated statements of operations. We estimate the fair value of these warrants using the BSM option-pricing formula.

7. Fair Value Measurements

ASC Topic 820, *Fair Value Measurements and Disclosures* ("ASC 820") defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in an active market for identical assets or liabilities.

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

[Table of Contents](#)

At September 30, 2009, there were outstanding warrants to purchase shares of our common stock that we classified as a liability with an estimated fair value of \$37,000 (see Note 6). These warrants were valued using Level 3 inputs because there are certain unobservable inputs associated with them. The following table reconciles the liability for these warrants measured at fair value on a recurring basis using Level 3 inputs for the six months ended September 30, 2009 (in thousands):

Balance at April 1, 2009	\$	—
Cumulative effect of accounting change (Note 6)		47
Gain on change in fair value included in net income		(10)
Balance at September 30, 2009	\$	37

This liability is included within accrued liabilities in the accompanying condensed consolidated balance sheet as of September 30, 2009.

The intangible assets acquired in connection with the Hamilton Signal acquisition (see Note 3) were recorded at fair value as of the acquisition date, and were estimated using the income approach, which generally included the use of certain Level 3 inputs. Our non-financial assets, such as goodwill, intangible assets and property and equipment are measured at fair value on a non-recurring basis; generally when there is a transaction involving those assets such as a purchase transaction, a business combination or an adjustment for impairment.

8. Stockholders' Equity

In August 2009, our Board of Directors adopted a stockholder rights plan, which calls for preferred stock purchase rights to be distributed, as a dividend, at the rate of one Right for each share of common stock held as of September 3, 2009. Each Right will entitle holders of common stock to buy one one-thousandth of a share of Series A Junior Participating Preferred Stock of Iteris. Further description and terms of the Rights are set forth in the Rights Agreement by and between us and Computershare Trust Company, N.A., as rights agent.

In connection with the stockholder rights plan, our Board of Directors approved the adoption of a Certificate of Designations, which created the Series A Junior Participating Preferred Stock, and likewise authorized the filing of a Certification of Elimination to eliminate the two series of junior participating preferred stock, which were originally created in April 1998 in connection with our previous stockholder rights plan which expired in 2008.

9. Stock-Based Compensation

A summary of activity in our stock option plans for the six months ended September 30, 2009 is as follows:

	Number of Shares (In thousands)	Weighted Average Exercise Price
Options outstanding at March 31, 2009	3,314	\$ 1.92
Granted	393	1.43
Exercised	(76)	1.19
Forfeited	(30)	2.49
Expired	(222)	1.80
Options outstanding at September 30, 2009	3,379	\$ 1.88

In September 2009, our stockholders approved an amendment to increase the number of shares of our common stock reserved for issuance under our 2007 Omnibus Incentive Plan by 800,000 shares to a total of 1,650,000 shares. At September 30, 2009, there were 853,000 shares of common stock available for grant under this plan.

The per share fair values of stock options granted in the six months ended September 30, 2009 have been estimated with the following weighted average assumptions:

Expected life - years	7
Risk-free interest rate	3.2%
Expected volatility of common stock	74%
Dividend yield	—
Weighted-average grant date fair value per share	\$ 1.01

[Table of Contents](#)

At September 30, 2009, there was approximately \$1.1 million of total unrecognized compensation expense related to unvested stock options. This expense is expected to be recognized over a weighted average period of approximately 3.4 years. If there are any modifications or cancellations of the underlying unvested stock options, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that we issue additional stock options or other stock-based awards.

10. Business Segment Information

We currently operate in three reportable segments: Roadway Sensors, Vehicle Sensors and Transportation Systems. The Roadway Sensors segment includes our Vantage and VersiCam vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications. The Vehicle Sensors segment includes our lane departure warning products and is comprised of all of our activities related to vehicle safety. The Transportation Systems segment includes transportation engineering and consulting services and the development of transportation management and traveler information systems for the ITS industry. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Certain corporate expenses, including interest and amortization of certain intangible assets, are not allocated to the segments. The reportable segments are each managed separately because they manufacture and distribute distinct products or provide services with different processes. All segment revenues are derived from external customers.

The following table sets forth selected unaudited financial information for our reportable segments for the three and six months ended September 30, 2009 and 2008:

	Roadway Sensors	Vehicle Sensors	Transportation Systems	Total
(In thousands)				
Three Months Ended September 30, 2009				
Product revenue	\$ 7,082	\$ 1,189	\$ —	\$ 8,271
Service and other revenue	—	191	6,403	6,594
Stock-based compensation	10	8	16	34
Depreciation and amortization	57	18	56	131
Segment income (loss)	1,182	(330)	390	1,242
Three Months Ended September 30, 2008				
Product revenue	\$ 7,617	\$ 3,177	\$ —	\$ 10,794
Service and other revenue	—	284	7,988	8,272
Stock-based compensation	8	12	13	33
Depreciation and amortization	48	36	64	148
Segment income	1,106	289	738	2,133
Six Months Ended September 30, 2009				
Product revenue	\$ 12,957	\$ 1,999	\$ —	\$ 14,956
Service and other revenue	—	439	14,104	14,543
Stock-based compensation	18	16	30	64
Depreciation and amortization	119	40	114	273
Segment income (loss)	1,544	(836)	924	1,632
Six Months Ended September 30, 2008				
Product revenue	\$ 15,043	\$ 5,903	\$ —	\$ 20,946
Service and other revenue	—	658	14,904	15,562
Stock-based compensation	16	24	26	66
Depreciation and amortization	96	73	120	289
Segment income	2,114	447	1,144	3,705

The following table reconciles segment income to consolidated income before income taxes:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands)			
Segment income:				
Total income from reportable segments	\$ 1,242	\$ 2,133	\$ 1,632	\$ 3,705
Unallocated amounts:				
Corporate and other expenses	(125)	(69)	(194)	(291)
Other income (expense), net	(2)	22	17	27
Interest expense, net	(71)	(198)	(157)	(396)
Income before income taxes	<u>\$ 1,044</u>	<u>\$ 1,888</u>	<u>\$ 1,298</u>	<u>\$ 3,045</u>

11. Subsequent Events

We have evaluated subsequent events through October 30, 2009, which represents the date these financial statements were issued.

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

This report, including the following discussion and analysis, contains forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995) that are based on our current expectations, estimates and projections about our business and our industry, and reflect management's beliefs and certain assumptions made by us based upon information available to us as of the date of this report. When used in this report and the information incorporated herein by reference, the words "expect(s)," "feel(s)," "believe(s)," "should," "will," "may," "anticipate(s)," "estimate(s)" and similar expressions or variations of these words are intended to identify forward-looking statements. These forward-looking statements include, but are not limited to, statements regarding our anticipated sales, revenue, expenses, profits, capital needs, competition, development plans, backlog and manufacturing capabilities, the applications for and acceptance of our products and services, and the status of our facilities and product development. These statements are not guarantees of future performance and are subject to certain risks and uncertainties that could cause our actual results to differ materially from those projected. You should not place undue reliance on these forward-looking statements that speak only as of the date hereof. We encourage you to carefully review and consider the various disclosures made by us which describe certain factors which could affect our business, including in "Risk Factors" set forth in Part II, Item 1A of this report, before deciding to invest in our company or to maintain or increase your investment. We undertake no obligation to revise or update publicly any forward-looking statement for any reason, including to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Overview

We are a leader in the traffic management market focused on the development and application of advanced technologies that reduce traffic congestion and improve the safety of surface transportation systems infrastructure. As an added benefit, our products and services minimize the environmental impact of traffic congestion. By combining outdoor image processing, traffic engineering and information technology, we offer a broad range of Intelligent Transportation Systems ("ITS") and driver safety solutions to customers worldwide.

We currently operate in three reportable segments: Roadway Sensors, Vehicle Sensors, and Transportation Systems. The Roadway Sensors segment includes our Vantage and VersiCam vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications. The Vehicle Sensors segment includes our lane departure warning ("LDW") products and is comprised of all of our activities related to vehicle safety. The Transportation Systems segment includes transportation engineering and consulting services, and the development of transportation management and traveler information systems for the ITS industry.

Our Roadway Sensors segment product line uses advanced image processing technology to capture and analyze video images through sophisticated algorithms, enabling vehicle detection and transmission of both video images and data using a wide range of communication technologies. Our Vantage video detection systems detect vehicle presence, count, speed and other traffic data used in traffic management systems. This gives traffic managers the ability to mitigate roadway congestion by modifying traffic signal timing or detecting incidents quickly. VersiCam, our integrated camera and processor video detection system, is a cost-efficient video detection system for smaller intersections that require only a few detection points. Vantage video detection systems have been deployed by hundreds of agencies and are currently sold through a network of independent dealers in the United States, Asia, Latin America, Europe and the Middle East.

[Table of Contents](#)

Our Vehicle Sensors segment addresses the leading cause of roadway fatalities: rear-end, lane change, and roadway departure accidents. We developed the world's first production LDW system and offer a proven system that is available as an OEM and aftermarket option on heavy trucks worldwide and as an option in passenger cars. Our LDW products utilize video detection images to detect when a vehicle begins to drift toward an unintended lane change. When this occurs, the unit automatically emits a distinctive rumble strip or other audible warning sound, alerting the driver to make a correction. To date, we have sold approximately 72,000 LDW systems into the heavy truck market in Europe, North America and Asia. Our LDW systems are currently qualified as an option on certain heavy trucks, including Mercedes-Benz, MAN, Iveco, DAF, Scania, Freightliner and FUSO, as well as Neoplan and MAN luxury bus and coach lines. In North America, our LDW systems are sold primarily to truck fleets. We believe that as a result the expected 2013 European mandate for LDW and other active safety systems, and an overall awareness of the potential benefits of LDW, that we will experience an even higher degree of competition from a variety of tier-one OEM suppliers and other potential market entrants, worldwide. We believe that this increased competition further validates the long term market opportunity for LDW systems in commercial vehicles. We are currently working with our major European OEM customer base to establish long-term supply agreements that extend to 2013 and beyond in order to meet the anticipated increase in demand. We cannot assure you that our efforts will be successful. We have also licensed our LDW technology to our strategic partner, Valeo Schalter and Sensoren GmbH ("Valeo"), resulting in sales to date of approximately 71,000 LDW systems for passenger cars. Additionally, we and our partner have experienced a greater degree of competition in the passenger car market, further validating LDW systems in this market as well. Several passenger car OEM's have recently introduced vehicle platforms with competing LDW systems. We and our partner Valeo continue to aggressively pursue opportunities in the passenger car market.

In addition to our LDW systems, our Vehicle Sensors portfolio includes technologies such as radar-based Forward Collision Warning ("FCW") and Blind Spot Warning ("BSW") systems for the North American truck market. Our Safety Direct product is a system that reports driver performance data captured by our LDW system and that has the ability to relay this information directly to fleet operators through integration with the truck's existing fleet communications system. We offer the FCW and BSW features through the resale of Delphi's radar based systems, for which we are the exclusive North American dealer, while Safety Direct was internally developed. These products, together with our LDW products, combine to create a suite of active safety driver assistance features that help to reduce the number of motor vehicle crashes and the severity of crash-related injuries.

Our Transportation Systems segment includes transportation engineering and consulting services focused on the planning, design, development and implementation of software-based systems that integrate sensors, video surveillance, computer, and advanced communications equipment to enable public agencies to monitor, control and direct traffic flow, assist in the quick dispatch of emergency crews and distribute real-time information about traffic conditions. Our services include planning, design and implementation of surface transportation infrastructure systems. We perform analysis and study goods movement, commercial vehicle operations, travel demand forecasting and systems engineering, and identify mitigation measures to reduce traffic congestion. These services and systems are primarily sold to local, state, and national transportation agencies in the United States.

Our Transportation Systems segment is largely dependent upon governmental funding and budgetary issues. We believe the overall expansion of our Transportation Systems segment in recent years was due in part to the passage of the Federal Highway Bill in 2005, combined with increased transportation funds available at state and local agencies throughout the country. The 2005 Federal Highway Bill is currently scheduled to expire on October 31, 2009, and Congress is currently in negotiations regarding future extensions. We anticipate possible delays in the enactment of a new federal highway bill; however, we believe the current level of funding will continue until such time that the new Bill is passed through Congress.

Despite the federal stimulus package, many municipalities and other agencies continue to face budgetary issues, whereby in some cases, spending for new roadways, new systems to address traffic congestion and other transportation infrastructure improvements has been delayed. Nevertheless, we believe that the need to rebuild and modernize aging transportation infrastructure will continue, and in addition to funds available through the stimulus package and federal highway bills, there exist a variety of other funding mechanisms that support transportation infrastructure and related projects, including bonds, dedicated tax measures and other alternative funding sources. At this point in time, we cannot determine when or if such funding sources will be available or the extent to which we may benefit from future sources of funding for transportation-related projects.

Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our unaudited condensed consolidated financial statements included herein, which have been prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosures of contingent assets and

[Table of Contents](#)

liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate these estimates and assumptions, including those related to the collectibility of accounts receivable, the valuation of inventories, the recoverability of long-lived assets and goodwill, the realizability of deferred tax assets, accounting for stock-based compensation, the valuation of equity instruments, warranty reserves and other contingencies. We base these estimates on our historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. These estimates and assumptions by their nature involve risks and uncertainties, and may prove to be inaccurate. In the event that any of our estimates or assumptions are inaccurate in any material respect, it could have a material adverse effect on our reported assets and liabilities at the date of the financial statements and our reported revenues and expenses during the reporting period.

The accounting policies that affect our more significant judgments and estimates used in the preparation of our unaudited condensed consolidated financial statements are those relating to revenue recognition, accounts receivable, inventory, goodwill, warranty, income taxes, and stock-based compensation. These policies are described in further detail in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009 ("fiscal 2009"). There have been no significant changes in our critical accounting policies and estimates during the six months ended September 30, 2009 as compared to what was previously disclosed in our Annual Report on Form 10-K for fiscal 2009.

Recent Accounting Pronouncements

Refer to Note 1 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item I of this report for a discussion of recent accounting pronouncements.

Results of Operations

The following table sets forth certain statement of operations data as a percentage of total net sales and contract revenues for the periods indicated:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Net sales and contract revenues:				
Net sales	56.9%	58.1%	52.2%	59.2%
Contract revenues	43.1	41.9	47.8	40.8
Total net sales and contract revenues	100.0%	100.0%	100.0%	100.0%
Costs of net sales and contract revenues:				
Cost of net sales	29.7	30.9	28.0	30.5
Cost of contract revenues	26.1	27.8	30.8	26.6
Gross profit	44.2	41.3	41.2	42.8
Operating expenses:				
Selling, general and administrative	30.5	24.4	29.8	26.9
Research and development	5.9	5.9	6.3	6.4
Amortization of intangible assets	0.3	0.2	0.3	0.2
Total operating expenses	36.7	30.5	36.3	33.5
Operating income	7.5	10.8	4.9	9.4
Non-operating income (expense):				
Other income (expense), net	(0.0)	0.1	0.1	0.1
Interest expense, net	(0.5)	(1.0)	(0.5)	(1.1)
Income before income taxes	7.0	9.9	4.4	8.3
Provision for income taxes	(3.4)	(4.3)	(2.1)	(3.6)
Net income	3.7%	5.6%	2.3%	4.7%

Analysis of Quarterly Results of Operations

Net Sales and Contract Revenues. Net sales are comprised of product sales from our Roadway Sensors and Vehicle Sensors segments, as well as contract engineering revenue and royalty revenue generated from our Vehicle Sensors segment. Contract revenues consist entirely of Transportation Systems contract revenues, which are generated from systems integration and ITS consulting services primarily with federal, state, county and municipal agencies.

[Table of Contents](#)

The following tables present details of our net sales and contract revenues for the three and six months ended September 30, 2009 and 2008:

	Three Months Ended September 30,			% Change
	2009	2008	Decrease	
	(In thousands, except percentages)			
Roadway Sensors	\$ 7,082	\$ 7,617	\$ (535)	(7.0)%
Vehicle Sensors	1,380	3,461	(2,081)	(60.1)
Net sales	8,462	11,078	(2,616)	(23.6)
Contract revenues	6,403	7,988	(1,585)	(19.8)
Total net sales and contract revenues	\$ 14,865	\$ 19,066	\$ (4,201)	(22.0)

	Six Months Ended September 30,			% Change
	2009	2008	Decrease	
	(In thousands, except percentages)			
Roadway Sensors	\$ 12,957	\$ 15,043	\$ (2,086)	(13.9)%
Vehicle Sensors	2,438	6,561	(4,123)	(62.8)
Net sales	15,395	21,604	(6,209)	(28.7)
Contract revenues	14,104	14,904	(800)	(5.4)
Total net sales and contract revenues	\$ 29,499	\$ 36,508	\$ (7,009)	(19.2)

We have historically had a diverse customer base. For the six months ended September 30, 2009, one individual customer accounted for approximately 10% of our total net sales and contract revenues. In the corresponding period in the prior year, no individual customer accounted for greater than 10% of our total net sales and contract revenues.

Roadway Sensors

The decrease in Roadway Sensors net sales for the three and six months ended September 30, 2009 as compared to the corresponding periods in the prior fiscal year was mainly due to the ongoing effects of reduced and delayed spending on infrastructure projects, in part due to the decline in commercial and residential construction as well as state and local government budgetary pressures. We believe these factors are at least partially attributable to the continued weakness in the U.S. and global economy. We expect the above factors, among others, may continue to adversely impact our Roadway Sensors net sales for at least the next few fiscal quarters. Additionally, winter weather conditions have historically had a negative impact on Roadway Sensors net sales in our fiscal third and fourth quarters in the regions where projects can be delayed due to such factors.

Vehicle Sensors

The largest element of Vehicle Sensors net sales was sales of our LDW systems to the heavy truck market, which aggregated approximately \$1.2 million and \$2.0 million for the three and six months ended September 30, 2009, respectively, compared to approximately \$3.2 million and \$5.9 million for the three and six months ended September 30, 2008, respectively. Vehicle Sensors net sales decreased for the current fiscal year primarily due to the ongoing slowdown in overall LDW unit shipments to each of our key markets. We currently continue to experience softness in our LDW unit sales to the North American truck market and to our European and Asian OEM customers, which we believe is driven largely by the general slowdown in the U.S. and worldwide credit markets and continued weakness in the overall global economy. We anticipate that Vehicle Sensors unit sales for the remainder of the fiscal year ended March 31, 2010 ("fiscal 2010") and beyond could also be adversely impacted as a result of the overall decline in sales of heavy trucks globally and by slower than expected adoption rates of our LDW system by European and Asian OEMs and North American heavy truck fleets. Additionally, future unit sales of LDW systems could be adversely impacted as a result of increased competition which contributed to a division of an international heavy truck customer sourcing future primary LDW unit sales to a competitor for a specific geographic region.

Also included in Vehicle Sensors net sales are revenues from contract engineering services and royalty revenues in the passenger car market that are derived from our strategic relationship with Valeo, which aggregated approximately \$191,000 and \$439,000 for the three and six months ended September 30, 2009, respectively, compared to \$284,000 and \$658,000 for the three and six months ended September 30, 2008, respectively.

Contract Revenues

Contract revenues are primarily dependent upon the continued availability of funding at both the state and federal levels from the various departments of transportation. For the three months ended September 30, 2009, our contract revenues decreased compared to the corresponding period in the prior fiscal year largely due to a reduction in sub-consulting content revenues as certain significant projects were completed in the current period. In the future, we plan to continue to pursue large contracts that may contain significant sub-consulting content, which will likely contribute to variability in the timing and amount of our contract revenues from period to period. We believe the ability of our Transportation Systems business to grow and successfully win and service new contracts will remain highly dependent upon our continued success in recruiting and retaining qualified personnel. Historically, all of our contract revenues have been derived from work performed in North America under a broad range of fixed price and cost plus fixed fee contracts. Beginning in the second quarter of fiscal 2010, we began work on our first overseas contract award to assist the Abu Dhabi Department of Transport in the development of certain ITS architecture. To date, revenues from this contract have not been significant.

[Table of Contents](#)

Gross Profit. The following tables present details of our gross profit for the three and six months ended September 30, 2009 and 2008:

	Three Months Ended September 30,			%
	2009	2008	Decrease	Change
	(In thousands, except percentages)			
Total gross profit	\$ 6,570	\$ 7,875	\$ (1,305)	(16.6)%
Total gross profit as a % of total net sales and contract revenues	44.2%	41.3%		
Gross profit as a % of net sales	47.9%	46.9%		
Gross profit as a % of contract revenues	39.4%	33.6%		

	Six Months Ended September 30,			%
	2009	2008	Decrease	Change
	(In thousands, except percentages)			
Total gross profit	\$ 12,152	\$ 15,627	\$ (3,475)	(22.2)%
Total gross profit as a % of total net sales and contract revenues	41.2%	42.8%		
Gross profit as a % of net sales	46.4%	48.4%		
Gross profit as a % of contract revenues	35.5%	34.7%		

Our gross margin for the three months ended September 30, 2009 increased compared to the corresponding period in the prior fiscal year primarily as a result of higher margins from our Transportation Systems contract revenues, as discussed further below. On a fiscal year-to-date basis, the slight decline in our gross margin in the current fiscal year, as compared to the same period in the prior fiscal year, was primarily the result of a higher mix of contract revenues, which represented approximately 48% of our total net sales and contract revenues thus far in the current fiscal year as compared to approximately 41% in the same period in the prior fiscal year. Generally, contract revenues carry lower margins than our net sales.

The slight increase in gross profit as a percent of net sales for the three months ended September 30, 2009 as compared to the corresponding period in the prior year was a result of higher margins in Roadway Sensors during the current quarter, primarily driven by our customer mix. The overall decrease in gross profit as a percent of net sales for the six months ended September 30, 2009 as compared to the corresponding period in the prior year was primarily a result of decreased gross profit in Vehicle Sensors, which was driven by lower overhead absorption due to the decline in sales in the current fiscal year, as well as an increase in certain estimates for additional excess and obsolete inventory provisions. Gross profit as a percentage of net sales can fluctuate in any specific quarter or year based on, among other factors, customer and product mix, competitive pricing requirements, product warranty costs and provisions for excess and obsolete inventories, as well as possible shifts of engineering resources from development activities to sustaining activities, which we record as cost of goods sold.

We recognize contract revenues and related gross profit using percentage of completion contract accounting, and the underlying mix of contract activity affects the related gross profit recognized in any given period. The increase in gross profit as a percent of contract revenues for the three months ended September 30, 2009 compared to the corresponding period in the prior year was primarily due to a contract mix weighted more toward higher margin contracts in the current quarter, which contained a significantly lower proportion of sub-consulting revenues. In subsequent quarters of fiscal 2010, we expect similarly lower levels of sub-consulting content as a percentage of our total contract revenues, as compared to recent prior fiscal quarters; however, due to the variability and timing of our contracts, it has become increasingly difficult to accurately predict sub-consulting content in future periods.

[Table of Contents](#)

Selling, General and Administrative Expense. The following tables present selling, general and administrative expense for the three and six months ended September 30, 2009 and 2008:

	Three Months Ended September 30, 2009		Three Months Ended September 30, 2008			
		% of Net Sales and Contract Revenues		% of Net Sales and Contract Revenues	Increase (Decrease)	% Change
	Amount		Amount			
	(In thousands, except percentages)					
Salary and personnel-related	\$ 3,020	20.3%	\$ 3,121	16.4%	\$ (101)	(3.2)%
Facilities, insurance and supplies	677	4.6	580	3.0	97	16.7
Travel and conferences	351	2.4	411	2.2	(60)	(14.6)
Professional and outside services	294	2.0	341	1.8	(47)	(13.8)
Other	185	1.2	200	1.0	(15)	(7.5)
Selling, general and administrative	<u>\$ 4,527</u>	<u>30.5%</u>	<u>\$ 4,653</u>	<u>24.4%</u>	<u>\$ (126)</u>	<u>(2.7)</u>

	Six Months Ended September 30, 2009		Six Months Ended September 30, 2008			
		% of Net Sales and Contract Revenues		% of Net Sales and Contract Revenues	Increase (Decrease)	% Change
	Amount		Amount			
	(In thousands, except percentages)					
Salary and personnel-related	\$ 5,907	20.0%	\$ 6,417	17.6%	\$ (510)	(7.9)%
Facilities, insurance and supplies	1,272	4.3	1,230	3.4	42	3.4
Travel and conferences	696	2.4	813	2.2	(117)	(14.4)
Professional and outside services	589	2.0	835	2.3	(246)	(29.5)
Other	316	1.1	513	1.4	(197)	(38.4)
Selling, general and administrative	<u>\$ 8,780</u>	<u>29.8%</u>	<u>\$ 9,808</u>	<u>26.9%</u>	<u>\$ (1,028)</u>	<u>(10.5)</u>

The decreases in selling, general and administrative expense for the three and six months ended September 30, 2009 compared to the corresponding periods in the prior year were primarily due to (i) our overall reduction in headcount from September 30, 2008 levels; (ii) lower accruals for bonuses and other incentive compensation; and (iii) the suspension of our matching contributions to our associates' 401(k) accounts effective July 1, 2009. During the current fiscal year, we also reduced our professional and outside services expenses primarily as a result of our efforts to conserve costs and scale back our usage of certain of these services as well as various efficiencies gained in our internal control assessment and other financial reporting obligations.

[Table of Contents](#)

Research and Development Expense. The following tables present research and development expense for the three and six months ended September 30, 2009 and 2008:

	Three Months Ended September 30, 2009		Three Months Ended September 30, 2008			
		% of Net Sales and Contract Revenues		% of Net Sales and Contract Revenues		%
	Amount		Amount		Decrease	Change
	(In thousands, except percentages)					
Salary and personnel-related	\$ 661	4.4%	\$ 754	4.0%	\$ (93)	(12.3)%
Facilities, development and supplies	195	1.3	301	1.6	(106)	(35.2)
Other	28	0.2	67	0.4	(39)	(58.2)
Research and development	<u>\$ 884</u>	<u>5.9%</u>	<u>\$ 1,122</u>	<u>5.9%</u>	<u>\$ (238)</u>	<u>(21.2)</u>
	Six Months Ended September 30, 2009		Six Months Ended September 30, 2008			
		% of Net Sales and Contract Revenues		% of Net Sales and Contract Revenues		%
	Amount		Amount		Decrease	Change
	(In thousands, except percentages)					
Salary and personnel-related	\$ 1,344	4.6%	\$ 1,630	4.5%	\$ (286)	(17.5)%
Facilities, development and supplies	431	1.5	565	1.5	(134)	(23.7)
Other	73	0.2	137	0.4	(64)	(46.7)
Research and development	<u>\$ 1,848</u>	<u>6.3%</u>	<u>\$ 2,332</u>	<u>6.4%</u>	<u>\$ (484)</u>	<u>(20.8)</u>

The decreases in research and development expense for the three and six months ended September 30, 2009 compared to the corresponding periods in the prior year were primarily due to lower overall engineering headcount and a shift in engineering resources to an organization more focused on new product development from one that has been historically focused on new customer qualification and manufacturing support. We believe this structure to be more efficient. Likewise, in the prior year, we had ramped up our research and development activities in Roadway Sensors aimed at accelerating the time to market of certain new products. We believe that research and development activities are crucial to our ability to continue to be a leader in our markets and we currently expect our expenditures in this area for fiscal 2010 will be slightly lower to flat when compared to fiscal 2009.

For competitive reasons, we closely guard the confidentiality of specific development projects.

Interest Expense, Net. Net interest expense of \$71,000 and \$157,000 for the three and six months ended September 30, 2009, respectively, was lower than the \$198,000 and \$396,000 for the three and six months ended September 30, 2008, respectively, primarily due to the overall lower level of borrowings in the current fiscal year, as well as lower interest rates on our term note.

[Table of Contents](#)

Income Taxes. The following tables present our provision for income taxes for the three and six months ended September 30, 2009 and 2008:

	Three Months Ended September 30,			%
	2009	2008	Decrease	Change
	(In thousands, except percentages)			
Provision for income taxes	\$ 501	\$ 821	\$ (320)	(39)%
Effective tax rate	48.0%	43.5%		

	Six Months Ended September 30,			%
	2009	2008	Decrease	Change
	(In thousands, except percentages)			
Provision for income taxes	\$ 611	\$ 1,312	\$ (701)	(53)%
Effective tax rate	47.1%	43.1%		

Our effective tax rates in the three and six months ended September 30, 2009 were slightly higher than those for the corresponding periods in the prior year due primarily to lower estimated projected pre-tax income in the current year compared to the prior year and the corresponding increased impact that certain non-deductible expenses will have on taxable income. On an interim basis, we estimate what our anticipated annual effective tax rate will be and record a quarterly income tax provision in accordance with this anticipated annual rate. As the fiscal year progresses, we refine our estimates based on actual events and financial results during the year. This process can result in significant changes to our expected effective tax rate. When this occurs, we adjust our income tax provision during the quarter in which our estimates are refined so that the year-to-date provision reflects the expected annual rate. These changes, along with adjustments to our deferred taxes, among others, may create fluctuations in our overall effective tax rate from quarter to quarter.

Liquidity and Capital Resources

Cash Flows

We have historically financed our operations with a combination of cash flows from operations, borrowings under credit facilities and the sale of equity securities. We currently rely on cash flows from operations and the availability of borrowings on a line of credit facility to fund our operations, which we believe are sufficient to fund our operations for at least the next twelve months. At September 30, 2009, we had \$20.6 million in working capital, which included no borrowings on our \$12.0 million line of credit and \$9.2 million in cash and cash equivalents. Our working capital at March 31, 2009 was also \$20.6 million and included no borrowings on our line of credit and \$6.4 million in cash and cash equivalents.

The following table summarizes our cash flows for the six months ended September 30, 2009 and 2008:

	Six Months Ended September 30,	
	2009	2008
	(In thousands)	
Net cash provided by (used in):		
Operating activities	\$ 3,666	\$ 3,384
Investing activities	(416)	(486)
Financing activities	(495)	452

Operating Activities. Cash provided by our operations for the six months ended September 30, 2009 was primarily the result of (i) our net income during the period of \$687,000; (ii) \$1.2 million in non-cash items within the statement of operations, primarily adjustments to our deferred tax assets and depreciation expense; and (iii) \$1.8 million in cash resulting from changes in our operating assets and liabilities during the period. Cash provided by operating activities during the six months ended September 30, 2008 was primarily the result of our net income during the period of \$1.7 million and adjustments to our deferred tax assets of \$1.0 million.

Our net accounts receivable decreased approximately \$1.9 million from March 31, 2009 to September 30, 2009 due in part to our lower overall quarterly net sales and contract revenues thus far in fiscal 2010 as compared to fiscal 2009 levels. We also experienced significant collections of our outstanding receivables, particularly in the latter part of the second quarter of fiscal 2010. In

[Table of Contents](#)

the future, our accounts receivable could increase if, among other factors, customers delay their payments or if we grant extended payment terms to customers, both of which are more likely to occur during challenging economic times when our customers may face issues gaining sufficient credit on a timely basis.

Inventories decreased approximately \$2.0 million from March 31, 2009 to September 30, 2009 as we worked through higher inventory levels on-hand as of March 31, 2009, which partially resulted from the introduction of certain new Roadway Sensors products and the acquisition of certain components that were discontinued by the manufacturer. We also focused on reducing our inventory purchases during this period to reflect the overall reduction in our net sales and the ongoing economic slowdown. In the future, our inventory levels are likely to continue to be determined based upon, among other factors, the level of purchase orders we receive from our customers, the stage at which our products are in their respective product life cycles, and competitive situations in the marketplace. We attempt to balance such considerations against risk of obsolescence or potentially excess inventory levels.

Investing Activities. Our investing activities for the six months ended September 30, 2009 consisted of purchases of property and equipment of \$116,000 as well as \$300,000 used for the acquisition of Hamilton Signal. Cash used in investing activities for the six months ended September 30, 2008 consisted entirely of purchases of property and equipment of \$486,000.

Financing Activities. Net cash used in financing activities during the six months ended September 30, 2009 was the result of net payments on our long-term debt of \$585,000, partially offset by \$90,000 in proceeds from the exercise of outstanding stock options to purchase shares of our common stock. During the six months ended September 30, 2008, cash provided by financing activities was primarily the result of \$684,000 in proceeds from the exercise of outstanding stock options to purchase shares of our common stock, partially offset by payments on long-term debt of \$232,000.

Borrowings

In October 2008, we entered into a \$19.5 million credit facility with California Bank & Trust, which provides for a two-year revolving line of credit with borrowings of up to \$12.0 million and a \$7.5 million 48-month term note (discussed below). Interest on borrowed amounts under the revolving line of credit are payable monthly at a rate equal to the current stated prime rate up to the current stated prime rate plus 0.50%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility (3.75% at September 30, 2009). We are obligated to pay an unused line fee of 0.25% per annum applied to the average unused portion of the revolving line of credit during the preceding month. The revolving line of credit does not contain any early termination fees and is secured by substantially all of our assets. As of September 30, 2009, no amounts were outstanding under the revolving line of credit portion of the facility.

As of September 30, 2009, we had outstanding borrowings of approximately \$6.7 million under the term note. Principal payments under this term note are required to be repaid in 48 monthly installments commencing on June 1, 2009. Additionally, beginning on November 1, 2009, and on November 1 of each year thereafter, we are required to pay additional principal of up to \$500,000, calculated based on certain financial measures, as further defined in the agreement. Interest on the term note is payable monthly at a rate equal to the current stated prime rate plus 0.50% up to the current stated prime rate plus 1.00% (4.25% at September 30, 2009), depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. The term note contains no early termination fees and, along with our revolving line of credit discussed above, is secured by substantially all of our assets.

In connection with our credit facility and loan agreement with California Bank & Trust, we are also required to comply with certain quarterly financial covenants. These include achieving certain ratios for working capital and debt service, as well as maintaining a level of profitability, all of which are further defined in the agreement. While we believe we are currently in compliance with all financial covenants and expect to maintain compliance for the foreseeable future, we cannot assure that we will not violate one or more covenants in the future. If we were to be in violation of covenants under this agreement, our lender could choose to accelerate payment on all outstanding loan balances and pursue its security interest in our assets. In this event, we cannot assure you that we would be able to quickly obtain equivalent or suitable replacement financing on acceptable terms, or at all. If we were not able to secure alternative sources of financing, such acceleration would have a material adverse impact on our business and financial condition.

Off Balance Sheet Arrangements

At September 30, 2009, we had outstanding warrants to purchase an aggregate of 246,250 shares of our common stock at an exercise price of \$3.25 per share that are callable by us if the market price of our common stock trades for 20 consecutive days at a price equal to or greater than \$6.50 per share. We also had outstanding warrants to purchase an aggregate of 75,000 shares of our common stock at an exercise price of \$5.00 per share that are callable by us if the market price of our common stock trades for 20 consecutive days at a price equal to or greater than \$7.50 per share.

[Table of Contents](#)

In connection with the issuance of warrants to purchase 246,250 shares of our common stock at \$3.25 per share (discussed above), we are a party to a registration rights agreement that contains provisions under which we could be subjected to liquidated damages should we fail to maintain effective registration statements for the shares of common stock issuable upon exercise of certain underlying warrants. Through March 31, 2009, these warrants were accounted for within equity in our consolidated balance sheets and, accordingly, no liabilities were recorded in connection therewith. Beginning April 1, 2009, as further discussed at Note 6 of Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report, because these warrants contain a provision for possible future adjustments to either the exercise price and/or number of shares to be issued upon exercise, we began recognizing these warrants as liabilities in our consolidated balance sheet. As of the date of this filing, no liquidated damages are payable under the provisions of the registration rights agreement associated with these warrants.

Seasonality

We have historically experienced, and expect to continue to experience seasonality, particularly with respect to our Roadway Sensors net sales in the third and fourth fiscal quarters due to a reduction in road construction or repairs during the winter months in many markets as a result of inclement weather conditions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to interest rate risk is limited to our line of credit and our new bank term note. Our line of credit bears interest equal to the prevailing prime rate (3.25% at September 30, 2009) plus 0% to 1.0%. We do not believe that a 10% increase in the interest rate on our line of credit or term note (from 3.25% to 4.68%) would have a material impact on our financial position, operating results or cash flows. In addition, we believe that the carrying value of our outstanding debt under our credit facility approximates fair value.

ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management necessarily applied its judgment in evaluating the cost-benefit relationship of such controls and procedures.

Changes in Internal Controls

During the fiscal quarter covered by this report, there has been no change in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Inherent Limitations on Internal Control

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of management override or improper acts, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple errors. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to management override, error or improper acts may occur and not be detected. Any resulting misstatement or loss may have an adverse and material effect on our business, financial condition and results of operations.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth under the heading “Litigation and Other Contingencies” in Note 5 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report, is incorporated herein by reference.

ITEM 1A. RISK FACTORS

Our business is subject to a number of risks, some of which are discussed below. Other risks are presented elsewhere in this report and in the information incorporated by reference into this report. You should consider the following risks carefully in addition to the other information contained in this report and our other filings with the SEC, including our annual report on Form 10-K and subsequent reports on Forms 10-Q and 8-K, before deciding to buy, sell, or hold our common stock. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. If any of these risks actually occurs, our business, financial condition, or results of operations could be seriously harmed. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

The economic slowdown has adversely impacted real estate development, reduced and delayed government funding for transportation infrastructure projects and initiatives and decreased availability of financial capital for our customers, all of which is adversely impacting our net sales and could impact our contract revenues. Decreased consumer spending, the failure of certain financial institutions and businesses, concerns about the availability and cost of credit, and reduced corporate profits and capital spending have resulted in a downturn in worldwide economic conditions, as well as budgetary shortfalls increasingly present at all levels of government. These unfavorable economic conditions are having a negative impact on customer orders and government funding of infrastructure projects incorporating our products and services. Such factors have and may continue to result in cancellations and rescheduling of backlog and customer orders. In addition, the recent decline in the U.S. real estate market, particularly in new home and commercial construction, is adversely impacted new road construction and is resulting in and may continue to result in flat or declining Roadway Sensor and Vehicle Sensor net sales in future periods and could also adversely impact Transportation Systems contract revenues. Any of the foregoing economic conditions make it extremely difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. Additionally, there continues to be uncertainties regarding the impact of the federal stimulus package and the fact that the accessibility of funds appears to be taking longer than originally anticipated, along with the expiration and extension of the 2005 Federal Highway Bill. If such conditions continue or worsen, our business, financial condition and results of operations could be materially and adversely affected.

Because we depend on government contracts and subcontracts, we face additional risks related to contracting with federal, state and local governments, including budgetary issues and fixed price contracts. A significant portion of our sales are derived from contracts with governmental agencies, either as a general contractor, subcontractor or supplier. Government contracts represented approximately 45%, 38% and 38% of our total net sales and contract revenues for the fiscal years ended March 31, 2009, 2008 and 2007, respectively. We anticipate that revenue from government contracts will continue to remain a significant portion of our net sales and contract revenues. Government business is, in general, subject to special risks and challenges, including:

- delays in funding, including delays in the allocation of funds to state and local agencies from the U.S. federal government as a result of the expiration of the 2005 Federal Highway Bill, currently scheduled for October 31, 2009, as well as delays or reductions in stimulus funds dedicated for transportation projects;
- long purchase cycles or approval processes;
- competitive bidding and qualification requirements;
- the impact of international conflicts;
- performance bond requirements;
- changes in government policies and political agendas;
- other government budgetary constraints, cut-backs, delays or reallocation of government funding;
- milestone requirements and liquidated damage provisions for failure to meet contract milestones; and
- international conflicts or other military operations that could cause the temporary or permanent diversion of government funding from transportation or other infrastructure projects.

[Table of Contents](#)

Governmental budgets and plans are subject to change without warning. Certain risks of selling to governmental entities include dependence on appropriations and administrative allocation of funds, changes in governmental procurement legislation and regulations and other policies that may reflect political developments or agendas, significant changes in contract scheduling, intense competition for government business and termination of purchase decisions for the convenience of the governmental entity. Substantial delays in purchase decisions by governmental entities, and the current constraints on government budgets at the federal, state and local level, could cause our net sales and contract revenues and income to drop substantially or to fluctuate significantly between fiscal periods.

In addition, a large number of our government contracts are fixed price contracts. As a result, we may not be able to recover any cost overruns we may incur. These fixed price contracts require us to estimate the total project cost based on preliminary projections of the project's requirements. The financial viability of any given project depends in large part on our ability to estimate these costs accurately and complete the project on a timely basis. In the event our costs on these projects exceed the fixed contractual amount, we will be required to bear the excess costs. Such additional costs would adversely affect our financial condition and results of operations. Moreover, certain of our government contracts are subject to termination or renegotiation at the convenience of the government, which could result in a large decline in our net sales and contract revenues in any given quarter. Our inability to address any of the foregoing concerns or the loss or renegotiation of any material government contract could seriously harm our business, financial condition and results of operations.

California state budgetary constraints may have a material adverse impact on us. The state of California has experienced, and is continuing to experience, a significant budget shortfall and other related budgetary issues and constraints. The state of California has historically been and is considered to be a key geographic region for our Roadway Sensors and Transportation Systems segments. Ongoing uncertainty as to the timing and accessibility of federal stimulus monies to the state, changes in state funding allocations to local agencies and municipalities, or other delays in purchasing for, or commencement of, transportation projects has and may continue to have a negative impact on our net sales and contract revenues and our income.

The markets in which we operate are highly competitive and have many more established competitors, which could adversely affect our sales or the market acceptance of our products. We compete with numerous other companies in our target markets including, but not limited to, large, multinational corporations, which include tier-one automotive suppliers, and many smaller regional engineering firms. We believe that as a result the expected 2013 European mandate for LDW and other active safety systems, and an overall awareness of the potential benefits of LDW, that we will experience an even higher degree of competition from a variety of tier-one OEM suppliers and other potential market entrants, worldwide. We also expect such competition to increase due to technological advancements, industry consolidations and reduced barriers to entry. Increased competition is likely to result in loss of market share, price reductions and reduced gross margins, any of which could seriously harm our business, financial condition and results of operations. For example, a developer of LDW systems was acquired by a large multinational organization during fiscal 2009. This new competitor has increased its market share and could be more aggressive in both the passenger car and heavy truck markets, as a result of its greater access to resources and reputation in the market. Furthermore, awareness of LDW technology is increasing and other market players have developed competing technologies, which may contain improvements or added features beyond those offered by our LDW systems. Additionally, from time to time, we may be required to re-compete for LDW business from our main customer base of heavy truck OEMs. These OEMs could make a supplier change based on price, product performance or available features. Should our competition be successful, this could adversely affect our ability to successfully market and sell our LDW systems to new and existing customers.

We generally compete with existing, well-established companies in our Roadway Sensors segment, both domestically and abroad. Certain technological barriers to entry make it difficult for new competitors to enter the market with competing video or other technologies; however, we are aware of new market entrants from time to time. Increased competition could result in loss of market share, price reductions and reduced gross margins, any of which could seriously harm our business, financial condition and results of operations. In the fiscal year ended March 31, 2007, we began to experience more competition in our Roadway Sensors segment as the Department of Transportation in one of our largest sales territories moved to a multi-source contracting environment from one in which we were the sole supplier.

Many of our competitors have far greater name recognition and greater financial, technological, marketing, and customer service resources than we do. This may allow them to respond more quickly to new or emerging technologies and changes in customer requirements. It may also allow them to devote greater resources to the development, promotion, sale and support of their products than we can. Recent consolidations of end users, distributors and manufacturers in our target markets have exacerbated this problem. As a result of the foregoing factors, we may not be able to compete effectively in our target markets and competitive pressures could adversely affect our business, financial condition and results of operations.

We may experience production gaps that could materially and adversely impact our sales and financial results and the ultimate acceptance of our products. It is possible that we could experience unforeseen quality control issues or part shortages as we adjust production to meet current demand for our products. We have historically used single suppliers for certain significant

components in our products. Should any such delay or disruption occur, or should a key supplier discontinue operations because of the current economic climate, our future sales will likely be materially and adversely affected. Additionally, we rely heavily on select contract manufacturers to produce many of our products and do not have any long-term contracts to guarantee supply of such products. Although we believe our contract manufacturers have sufficient capacity to meet our production schedules for the foreseeable future and we believe we could find alternative contract manufacturing sources for many of our products, if necessary, we could experience a production gap if for any reason our contract manufacturers were unable to meet our production requirements and our cost of goods sold could increase, adversely affecting our margins.

We may be unable to attract and retain key personnel, which could seriously harm our business. Due to the specialized nature of our business, we are highly dependent on the continued service of our executive officers and other key management, engineering and technical personnel. The loss of Abbas Mohaddes, our Chief Executive Officer, or any of the other executive officers or key members of management could adversely affect our business, financial condition, or results of operations. Our success will also depend in large part upon our ability to continue to attract, retain and motivate qualified engineering and other highly skilled technical personnel. In particular, the future success of our Transportation Systems segment will depend on our ability to hire additional qualified engineers and planners. Competition for qualified employees, particularly development engineers, is intense. We may not be able to continue to attract and retain sufficient numbers of such highly skilled employees. Our inability to attract and retain additional key employees or the loss of one or more of our current key employees could adversely affect our business, financial condition and results of operations.

If we are unable to develop and introduce new products and product enhancements successfully and in a cost-effective and timely manner, or are unable to achieve market acceptance of our new products, our operating results would be adversely affected. We believe our revenue growth and future operating results will depend on our ability to complete development of new products and enhancements, introduce these products in a timely, cost-effective manner, achieve broad market acceptance of these products and enhancements, and reduce our production costs. We cannot guarantee the success of these products, and we may not be able to introduce any new products or any enhancements to our existing products on a timely basis, or at all. In addition, the introduction of any new products could adversely affect the sales of certain of our existing products.

We believe that we must continue to make substantial investments to support ongoing research and development in order to remain competitive. We need to continue to develop and introduce new products that incorporate the latest technological advancements in outdoor image processing hardware, software and camera technologies in response to evolving customer requirements. We cannot assure you that we will be able to adequately manage product transition issues. Our business and results of operations could be adversely affected if we do not anticipate or respond adequately to technological developments or changing customer requirements or if we cannot adequately manage inventory issues typically related to new product transitions and introductions. We cannot assure you that any such investments in research and development will lead to any corresponding increase in revenue.

Market acceptance of our new products depends upon many factors, including our ability to accurately predict market requirements and evolving industry standards, our ability to resolve technical challenges in a timely and cost-effective manner, qualify any new products with OEMs and achieve manufacturing efficiencies, the perceived advantages of our new products over traditional products and the marketing capabilities of our independent distributors and strategic partners, including Valeo's ability to expand sales of LDW systems in the passenger car market. The success of our LDW system will also depend in part on the success of the automotive vehicles that incorporate our technology, as well as the success of optional equipment that OEMs bundle with our technologies.

Certain of the components used in our products may need to be re-engineered in the next 12 to 36 months as the industry is moving towards a standard of using lead-free components. We cannot assure you as to the timing of the adoption of this new standard or our ability to successfully redesign our products to incorporate compliant components and gain market acceptance of such redesigned products. In addition, if the standard is adopted earlier than anticipated, we may experience a shortage of products as a result of potential scarcity of lead-free components.

Our business and results of operations could also be seriously harmed by any significant delays in our new product development. Certain of our new products could contain undetected design faults and software errors or "bugs" when first released by us, despite our testing. We may not discover these faults or errors until after a product has been installed and used by our customers. Any faults or errors in our existing products or in any new products may cause delays in product introduction and shipments, require design modifications or harm customer relationships, any of which could adversely affect our business and competitive position.

New environmental regulations may result in a decline in our Vehicle Sensors net sales. From time to time, environmental regulations are enacted, which can significantly increase the cost of manufacturing new vehicles as well as the cost of maintenance of existing vehicles and truck fleets. As a result, we could experience a decline in sales of our Vehicle Sensors products as truck and vehicle manufacturers and fleet operators attempt to control their costs.

We may engage in acquisitions of companies or technologies that may require us to undertake significant capital infusions and could result in disruptions of our business and diversion of resources and management attention. We have in the past acquired, and may in the future acquire, complementary businesses, products, and technologies. Acquisitions may require significant capital infusions and, in general, acquisitions also involve a number of special risks, including:

- potential disruption of our ongoing business and the diversion of our resources and management's attention;
- the failure to retain or integrate key acquired personnel;
- the challenge of assimilating diverse business cultures, and the difficulties in integrating the operations, technologies and information system of the acquired companies;
- increased costs to improve managerial, operational, financial and administrative systems and to eliminate duplicative services;
- the incurrence of unforeseen obligations or liabilities;
- potential impairment of relationships with employees or customers as a result of changes in management; and
- increased interest expense and amortization of acquired intangible assets.

Our competitors are also soliciting potential acquisition candidates, which could both increase the price of any acquisition targets and decrease the number of attractive companies available for acquisition. Acquisitions may also materially and adversely affect our operating results due to large write-offs, contingent liabilities, substantial depreciation, deferred compensation charges or intangible asset amortization, or other adverse tax or accounting consequences. We cannot assure you that we will be able to identify or consummate any additional acquisitions, successfully integrate any acquisitions or realize the benefits anticipated from any acquisition.

We depend upon Valeo to market our LDW technologies for the OEM passenger car market. We have granted Valeo the exclusive right to sell and manufacture our LDW system to the worldwide passenger car market in exchange for royalty payments for each LDW unit sold. As such, the future success and broad market acceptance of our technologies in the passenger car market will depend upon Valeo's ability to manufacture, market and sell our technologies, and to convince more OEM passenger car manufacturers to adopt our technologies. To date, we have not generated significant royalties from Valeo's efforts and have only been designed into one car OEM product line. If Valeo does not devote considerable resources and aggressively pursue opportunities, our expansion into the passenger car market, and our related revenues from contract engineering services and royalty revenues could be adversely affected or not materialize as originally anticipated.

If we do not keep pace with rapid technological changes and evolving industry standards, we will not be able to remain competitive and there will be no demand for our products. Our markets are in general characterized by the following factors:

- rapid technological advances;
- downward price pressure in the marketplace as technologies mature;
- changes in customer requirements;
- additional qualification requirements related to new products or components;
- frequent new product introductions and enhancements;
- inventory issues related to transition to new or enhanced models; and
- evolving industry standards and changes in the regulatory environment.

Our future success will depend upon our ability to anticipate and adapt to changes in technology and industry standards, and to effectively develop, introduce, market and gain broad acceptance of new products and product enhancements incorporating the latest technological advancements. In particular, our LDW systems are incorporated into automobiles and trucks that face significant technological changes in each model year and among different vehicle models. Accordingly, we must adapt our technology from time to time to function with such changes.

Our international business operations may be threatened by many factors that are outside of our control. We currently market our products internationally and we anticipate that our international operations may expand in the near future. International business operations are subject to various inherent risks including, among others:

- currency fluctuations and restrictions;
- political, social and economic instability;
- longer accounts receivable payment cycles;
- import and export license requirements and restrictions of the United States and each other country in which we operate;
- unexpected changes in regulatory requirements, tariffs and other trade barriers or restrictions;
- the burdens of compliance with a wide variety of foreign laws and more restrictive labor laws and obligations;
- difficulties in managing and staffing international operations;
- potentially adverse tax consequences; and
- reduced protection for intellectual property rights in some countries.

All of our international sales are denominated in U.S. dollars. As a result, an increase in the relative value of the dollar could make our products more expensive and potentially less price competitive in international markets. We do not engage in any transactions as a hedge against risks of loss due to foreign currency fluctuations.

[Table of Contents](#)

Any of the factors mentioned above may adversely affect our future international sales and, consequently, affect our business, financial condition and operating results. Furthermore, as we increase our international sales, our total revenues may also be affected to a greater extent by seasonal fluctuations resulting from lower sales that typically occur during the summer months in Europe and other parts of the world.

If our internal controls over financial reporting do not comply with the requirements of the Sarbanes-Oxley Act, our business and stock price could be adversely affected. Section 404 of the Sarbanes-Oxley Act of 2002 currently requires us to evaluate the effectiveness of our internal controls over financial reporting at the end of each fiscal year and to include a management report assessing the effectiveness of our internal controls over financial reporting in all annual reports. Beginning in our fiscal year ending March 31, 2011, our independent registered public accounting firm will also be required to attest to, and report on, the effectiveness of our internal controls over financial reporting. We may not be able to complete the work required for such attestation on a timely basis, and even if we timely complete such requirements, our independent registered public accounting firm may still conclude that our internal controls over financial reporting are not effective.

Our management, including our CEO and CFO, does not expect that our internal controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Iteris have been or will be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, our controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

We may need to raise additional capital in the future, which may not be available on terms acceptable to us, or at all. Until recently, we have historically generated significant net losses and operating losses, and have experienced volatility in our cash flows from operations from year to year. Although we entered into a \$19.5 million credit facility, effective October 2008, should we have an event of default, which includes, among other things, a failure to meet certain financial covenants and a material adverse change in the business, the bank could choose to limit or take away our ability to borrow these or any funds. Should this occur, or if the credit markets further tighten, we may need or choose to raise additional capital to pursue acquisitions or to expand our operations.

At September 30, 2009, we had \$9.2 million of cash and cash equivalents and our entire \$12.0 million line of credit to fund our operations. We may need to raise additional capital in the near future to fund our operations or to repay indebtedness. Such additional capital may be raised through bank borrowings, or other debt or equity financings. We cannot assure you that any additional capital will be available on a timely basis, on acceptable terms, or at all, and such additional financing may result in further dilution to our stockholders.

Our capital requirements will depend on many factors, including, but not limited to:

- market acceptance of our products and product enhancements, and the overall level of sales of our products;
- our ability to control costs;
- the supply of key components for our products;
- our ability to increase revenue and net income;
- increased research and development expenses and sales and marketing expenses;
- our need to respond to technological advancements and our competitors' introductions of new products or technologies;
- capital improvements to new and existing facilities and enhancements to our infrastructure and systems;
- potential acquisitions of businesses and product lines;
- our relationships with customers and suppliers;

[Table of Contents](#)

- government budgets, political agendas and other funding issues, including potential delays in government contract awards;
- our ability to successfully negotiate credit arrangements with our bank and repay our subordinated convertible debentures; and
- general economic conditions, including the effects of the current economic slowdown and international conflicts.

If our capital requirements are materially different from those currently planned, we may need additional capital sooner than anticipated. If additional funds are raised through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders will be reduced and such securities may have rights, preferences and privileges senior to our common stock. Additional financing may not be available on favorable terms, on a timely basis, or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to continue our operations as planned, develop or enhance our products, expand our sales and marketing programs, take advantage of future opportunities or respond to competitive pressures.

Our quarterly operating results fluctuate as a result of many factors. Therefore, we may fail to meet or exceed the expectations of securities analysts and investors, which could cause our stock price to decline. Our quarterly revenues and operating results have fluctuated and are likely to continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. Factors that could affect our revenues include, among others, the following:

- delays in government contracts and funding from time to time and budgetary constraints at the federal, state and local levels, including stimulus and other funding;
- declines in new home and commercial real estate construction and related road and other infrastructure construction;
- changes in our pricing policies and the pricing policies of our suppliers and competitors, pricing concessions on volume sales, as well as increased price competition in general;
- the long lead times associated with government contracts or required by vehicle manufacturers;
- the size, timing, rescheduling or cancellation of significant customer orders;
- our ability to control costs;
- our ability to raise additional capital;
- the mix of our products and services sold in a quarter, which mix has varied and is expected to continue to vary from time to time;
- seasonality due to winter weather conditions;
- international conflicts and acts of terrorism;
- our ability to develop, introduce, patent, market and gain market acceptance of new products, applications and product enhancements in a timely manner, or at all;
- market acceptance of the products incorporating our technologies and products;
- the introduction of new products by competitors;
- the availability and cost of components used in the manufacture of our products;
- our success in expanding and implementing our sales and marketing programs;
- the effects of technological changes in our target markets;
- the amount of our backlog at any given time;
- the nature of our government contracts;
- deferrals of customer orders in anticipation of new products, applications or product enhancements;

[Table of Contents](#)

- risks and uncertainties associated with our international business;
- currency fluctuations and our ability to get currency out of certain foreign countries; and
- general economic and political conditions.

Due to all of the factors listed above as well as other unforeseen factors, our future operating results could be below the expectations of securities analysts or investors. If that happens, the trading price of our common stock could decline. As a result of these quarterly variations, you should not rely on quarter-to-quarter comparisons of our operating results as an indication of our future performance.

We have experienced growth in recent years. If we fail to manage our growth effectively, we may be unable to execute our business plan and may experience future weaknesses in our internal controls. We have expanded our overall business in the past few years. In order to achieve our business objectives, we will need to continue to expand our business and add additional qualified personnel. Such expansion has placed and is expected to continue to place, a significant strain on our managerial, administrative, operational, financial and other resources. If we are unable to successfully manage our growth, our business, financial condition and results of operations will be adversely affected.

We may not be able to adequately protect or enforce our intellectual property rights, which could harm our competitive position. If we are not able to adequately protect or enforce the proprietary aspects of our technology, competitors could be able to access our proprietary technology and our business, financial condition and results of operations will likely be seriously harmed. We currently attempt to protect our technology through a combination of patent, copyright, trademark and trade secret laws, employee and third party nondisclosure agreements and similar means. Despite our efforts, other parties may attempt to disclose, obtain or use our technologies or systems. Our competitors may also be able to independently develop products that are substantially equivalent or superior to our products or design around our patents. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. As a result, we may not be able to protect our proprietary rights adequately in the United States or abroad.

Litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation may also be necessary to defend against claims of infringement or invalidity by others. An adverse outcome in litigation or any similar proceedings could subject us to significant liabilities to third parties, require us to license disputed rights from others or require us to cease marketing or using certain products or technologies. We may not be able to obtain any licenses on terms acceptable to us, or at all. We also may have to indemnify certain customers or strategic partners if it is determined that we have infringed upon or misappropriated another party's intellectual property. Any of these results could adversely affect our business, financial condition and results of operations. In addition, the cost of addressing any intellectual property litigation claim, including legal fees and expenses, and the diversion of management's attention and resources, regardless of whether the claim is valid, could be significant and could seriously harm our business, financial condition and results of operations.

We have historically experienced substantial losses and may experience losses in the future. Although we have achieved net income in our past four fiscal years, we experienced a net loss of \$11.3 million in the year ended March 31, 2005 and significant net losses in prior years. We cannot assure you that we will be able to sustain or improve our financial performance, or that we will be able to continue to achieve profitability on a quarterly or annual basis in the future. Most of our expenses are fixed in advance. As such, we generally are unable to reduce our expenses significantly in the short-term to compensate for any unexpected delay or decrease in anticipated revenues. As a result, we may experience operating losses and net losses in the future, which would make it difficult to fund our operations and achieve our business plan, and could cause the market price of our common stock to decline.

The trading price of our common stock is highly volatile. The trading price of our common stock has been subject to wide fluctuations in the past. Since January 2001, our Class A common stock (now known as our common stock) has traded at prices as low as \$0.45 per share and as high as \$8.00 per share. The market price of our common stock could continue to fluctuate in the future in response to various factors, including, but not limited to:

- quarterly variations in operating results;
- our ability to control costs, improve cash flow and sustain profitability;
- our ability to raise additional capital;
- shortages announced by suppliers;
- announcements of technological innovations or new products or applications by our competitors, customers or us;

[Table of Contents](#)

- transitions to new products or product enhancements;
- acquisitions of businesses, products or technologies;
- the impact of any litigation;
- changes in investor perceptions;
- government funding, political agendas and other budgetary constraints;
- changes in earnings estimates or investment recommendations by securities analysts; and
- international conflicts, political unrest and acts of terrorism.

The stock market in general has from time to time experienced volatility, which has often affected the market prices of equity securities of many technology companies. This volatility has often been unrelated to the operating performance of these companies. These broad market fluctuations may adversely affect the market price of our common stock. In the past, companies that have experienced volatility in the market price of their securities have been the subject of securities class action litigation. If we were to become the subject of a class action lawsuit, it could result in substantial losses and divert management's attention and resources from other matters.

We could experience negative financial impacts arising from developments in contingencies created under our previous structure or by former subsidiaries. Although we divested ourselves of all business units prior to October 2004, from time to time we could experience unforeseen developments in contingencies related to our former subsidiaries. For example, in July 2006 we entered into a settlement agreement in connection with a lawsuit brought against Mariner Networks, Inc., one of our former subsidiaries, by one of Mariner's suppliers, pursuant to which we issued 88,912 shares of our common stock to this supplier (valued at \$213,000 as of the date of issuance) and paid \$475,000 in cash. Although we are not aware of any other material contingencies, it is possible other matters could be brought against us in connection with activities related to former subsidiaries and that such matters could materially and adversely affect our financial results and cash flows.

Certain provisions of the Company's charter documents may discourage a third party from acquiring us and may adversely affect the price of our common stock. Certain provisions of our certificate of incorporation could make it difficult for a third party to acquire us, even though an acquisition might be beneficial to our stockholders. Such provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. Under the terms of our certificate of incorporation, our Board of Directors is authorized to issue, without stockholder approval, up to 2,000,000 shares of preferred stock with voting, conversion and other rights and preferences superior to those of our common stock. In addition, in August 2009, we adopted a stockholder rights plan and declared a dividend of preferred stock purchase rights to our stockholders. Generally, the stockholder rights plan provides that if a person or group acquires 15% or more of our common stock, subject to certain exceptions and under certain circumstances, the rights may be exchanged by us for common stock or the holders of the rights, other than the acquiring person or group, could acquire additional shares of our capital stock at a discount off of the then current market price. Such exchanges or exercise of rights could cause substantial dilution to a particular acquirer and discourage the acquirer from pursuing our company. The mere existence of a stockholder rights plan often delays or makes a merger, tender offer or proxy contest more difficult.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

In connection with our Annual Meeting of Stockholders held on September 18, 2009, the following proxies were tabulated representing 23,675,074 shares of our common stock, or 69.1% of the outstanding shares as of the record date for the meeting:

Proposal I: Election of the Board of Directors

Director Nominee	Total Votes for Each Director	Total Votes Withheld from Each Director
Richard J. Char	22,575,356	1,099,718
Kevin C. Daly, Ph.D.	22,380,759	1,294,315
Gregory A. Miner	22,371,144	1,303,930
Abbas Mohaddes	22,567,287	1,107,787
John W. Seazholtz	22,475,220	1,199,854
Joel Slutzky	20,420,415	3,254,659
Thomas L. Thomas	22,417,314	1,257,760

Proposal II: Approval of an amendment to the 2007 Omnibus Incentive Plan to increase the number of shares of common stock authorized under the plan by an additional 800,000 shares, to 1,650,000 shares

	Shares of Common Stock
For	11,575,269
Against	962,285
Abstain	81,824
Non-votes	10,873,696

Proposal III: Ratification of McGladrey & Pullen, LLP as the independent auditors of Iteris for the fiscal year ending March 31, 2010

	Shares of Common Stock
For	23,461,419
Against	58,113
Abstain	155,542
Non-votes	—

ITEM 5. OTHER INFORMATION

One of our executive officers, James S. Miele, has entered into a trading plan pursuant to Rule 10b5-1(c)(1) of the Securities Exchange Act of 1934, as amended, which covers an aggregate of 40,000 shares of our common stock to be sold at prices ranging from \$2.60 to \$3.10. The option shares are set to expire on September 26, 2011.

ITEM 6. EXHIBITS

The following exhibits are filed herewith or are incorporated by reference to the location indicated.

Exhibit Number	Description	Where Located
3.1	Restated Certificate of Incorporation of the registrant	<i>Filed herewith</i>
3.2	Certificate of Designations of Series A Junior Participating Preferred Stock	<i>Filed herewith</i>
3.3	Bylaws of registrant, as amended	<i>Exhibit 4.2 to the registrant's Registration Statement on Form S-1 (Reg. No. 033-67932) as filed with the SEC on July 6, 1993</i>
3.4	Certificates of Amendment to Bylaws of the registrant dated April 24, 1998 and August 10, 2001	<i>Exhibit 3.4 to the registrant's Annual Report on Form 10-K/A for the year ended March 31, 2003 as filed with the SEC on July 29, 2003</i>
3.5	Certificate of Amendment to Bylaws of registrant dated September 9, 2004	<i>Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 as filed with the SEC on November 15, 2004</i>
3.6	Certificate of Amendment to Bylaws of registrant dated September 16, 2005	<i>Exhibit 3.5 to the registrant's Annual Report on Form 10-K for the year ended March 31, 2007 as filed with the SEC on June 21, 2007</i>

[Table of Contents](#)

3.7	Certificate of Amendment to Bylaws of registrant dated December 7, 2007	<i>Exhibit 3.1 to the registrant's Current Report on Form 8-K as filed with the SEC on December 13, 2007</i>
3.8	Certificate of Amendment to Bylaws of registrant, effective August 20, 2009	<i>Exhibit 3.3 to the registrant's Current Report on Form 8-K as filed with the SEC on August 21, 2009</i>
4.1	Specimen of Common Stock Certificate	<i>Exhibit 4.1 to the registrant's Amendment No. 1 to the Registration Statement on Form 8-A as filed with the SEC on December 8, 2004</i>
4.2	Rights Agreement dated August 20, 2009 between the registrant and Computershare Trust Company, N.A., including exhibits thereto	<i>Exhibit 4.1 to the registrant's Current Report on Form 8-K as filed with the SEC on August 21, 2009</i>
10.1	Unsecured Promissory Note dated August 10, 2009 executed by MAXxess Systems, Inc.	<i>Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 as filed with the SEC on August 11, 2009</i>
31.1	Certification of the Principal Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>
31.2	Certification of the Principal Financial and Accounting Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>
32.1	Certification of the Chief Executive Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>
32.2	Certification of the Chief Financial Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>

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.

Dated: October 30, 2009

ITERIS, INC.
(Registrant)

By /S/ ABBAS MOHADDES
Abbas Mohaddes
Chief Executive Officer
(Principal Executive Officer)

By /S/ JAMES S. MIELE
James S. Miele
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit Index

Exhibit Number	Description	Where Located
3.1	Restated Certificate of Incorporation of the registrant	<i>Filed herewith</i>
3.2	Certificate of Designations of Series A Junior Participating Preferred Stock	<i>Filed herewith</i>
3.3	Bylaws of registrant, as amended	<i>Exhibit 4.2 to the registrant's Registration Statement on Form S-1 (Reg. No. 033-67932) as filed with the SEC on July 6, 1993</i>
3.4	Certificates of Amendment to Bylaws of the registrant dated April 24, 1998 and August 10, 2001	<i>Exhibit 3.4 to the registrant's Annual Report on Form 10-K/A for the year ended March 31, 2003 as filed with the SEC on July 29, 2003</i>
3.5	Certificate of Amendment to Bylaws of registrant dated September 9, 2004	<i>Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 as filed with the SEC on November 15, 2004</i>
3.6	Certificate of Amendment to Bylaws of registrant dated September 16, 2005	<i>Exhibit 3.5 to the registrant's Annual Report on Form 10-K for the year ended March 31, 2007 as filed with the SEC on June 21, 2007</i>
3.7	Certificate of Amendment to Bylaws of registrant dated December 7, 2007	<i>Exhibit 3.1 to the registrant's Current Report on Form 8-K as filed with the SEC on December 13, 2007</i>
3.8	Certificate of Amendment to Bylaws of registrant, effective August 20, 2009	<i>Exhibit 3.3 to the registrant's Current Report on Form 8-K as filed with the SEC on August 21, 2009</i>
4.1	Specimen of Common Stock Certificate	<i>Exhibit 4.1 to the registrant's Amendment No. 1 to the Registration Statement on Form 8-A as filed with the SEC on December 8, 2004</i>
4.2	Rights Agreement dated August 20, 2009 between the registrant and Computershare Trust Company, N.A., including exhibits thereto	<i>Exhibit 4.1 to the registrant's Current Report on Form 8-K as filed with the SEC on August 21, 2009</i>
10.1	Unsecured Promissory Note dated August 10, 2009 executed by MAXxess Systems, Inc.	<i>Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 as filed with the SEC on August 11, 2009</i>
31.1	Certification of the Principal Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>
31.2	Certification of the Principal Financial and Accounting Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>
32.1	Certification of the Chief Executive Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>
32.2	Certification of the Chief Financial Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>

**RESTATED CERTIFICATE OF INCORPORATION
OF
ITERIS, INC.**

Iteris, Inc., a corporation organized and existing under the laws of the State of Delaware, hereby certifies as follows:

I. The original certificate of incorporation of this corporation was filed with the Secretary of State of the State of Delaware on July 13, 1987 under the name Odetics, Inc.

II. This Restated Certificate of Incorporation restates and integrates and does not further amend the provisions of the corporation's certificate of incorporation as heretofore amended or supplemented, and there is no discrepancy between such provisions and the provisions of this Restated Certificate of Incorporation. The restatement of the certificate of incorporation of the corporation, as heretofore amended or supplemented, has been duly approved by the directors of the corporation in accordance with Section 245 of the General Corporation Law of the State of Delaware.

III. The certificate of incorporation of the corporation, as heretofore amended or supplemented, is hereby restated to read in full as follows:

FIRST: The name of the corporation is Iteris, Inc. (the "Corporation").

SECOND: The address of the registered office of the Corporation in the State of Delaware is 32 W. Loockerman Street, Suite 201, in the City of Dover, County of Kent. The name of the Corporation's registered agent at that address is Registered Agent Solutions, Inc.

THIRD: The purpose of the Corporation is to engage in any lawful act or activity for which corporations may now or hereafter be organized under the General Corporation Law of the State of Delaware.

FOURTH:

A. The total number of shares of stock which the Corporation shall have authority to issue is 72,000,000, consisting of 70,000,000 shares of Common Stock, par value \$0.10 per share (the "Common Stock"), and 2,000,000 shares of Preferred Stock, par value \$1.00 per share (the "Preferred Stock").

B. Shares of Preferred Stock may be issued from time to time in one or more classes or series, each of which class or series shall have such distinctive designation or title as shall be fixed by resolution of the Board of Directors of the Corporation (the "Board of Directors" or the "Board") prior to the issuance of any shares thereof. Each such class or series of Preferred Stock shall have such voting powers, full or limited, or no voting powers, and such preferences and relative, participating, optional or other special rights, and such qualifications, limitations or restrictions thereon, as shall be stated in such resolution providing for the issuance

of such class or series of Preferred Stock as may be adopted from time to time by the Board of Directors prior to the issuance of any shares thereof pursuant to the authority hereby expressly vested in it, all in accordance with the laws of the State of Delaware. The Board of Directors is further authorized to increase or decrease (but not below the number of shares of such class or series then outstanding) the number of shares of any class or series subsequent to the issuance of shares of that class or series.

C. Common Stock Voting Rights. The holder of each share of Common Stock shall have the right to one vote per share and shall be entitled to vote upon such matters and in such manner as may be provided by law or by this Restated Certificate of Incorporation or by the Bylaws of the Corporation.

FIFTH: In furtherance and not in limitation of the powers conferred by statute and subject to Article Sixth hereof, the Board of Directors is expressly authorized to adopt, repeal, rescind, alter or amend in any respect the Bylaws with the exception that a bylaw specifying or changing a fixed number of directors or the maximum or minimum number of directors or changing from a fixed to a variable board may be adopted only by approval of a majority of the outstanding shares of each class of common stock; provided, however, that an amendment reducing the number of directors to a number less than five cannot be adopted if the votes cast against its adoption at a meeting, or the shares not consenting in the case of action by written consent, are equal to more than 16-2/3% of the outstanding shares entitled to vote.

SIXTH: Notwithstanding Article Fifth hereof, the Bylaws may be adopted, repealed, rescinded, altered or amended in any respect by the stockholders of the Corporation, or by the affirmative vote of a majority of the voting power of all outstanding shares, regardless of class and voting together as a single voting class subject to the terms of Article Fourth hereof.

SEVENTH: The business and affairs of the corporation shall be managed by and under the direction of the Board of Directors. Except as may otherwise be provided in this Restated Certificate of Incorporation, the exact number of directors of the Corporation shall be determined from time to time by a Bylaw or amendment thereto.

EIGHTH: Directors shall be elected at each annual meeting of stockholders and may be elected at any special meeting of stockholders called for that purpose, to serve until the next annual meeting of stockholders and until their respective successors are elected, unless they shall sooner resign, become disqualified or disabled or be removed from office. A director or the entire Board of Directors may be removed with or without cause by the affirmative vote of the holders of a majority of the securities entitled to vote for each director, provided that (if less than the entire number of directors elected by a particular class of securities is removed) the shares voted against such removal would not be sufficient to elect the director or directors in any election involving cumulative voting by stockholders. A director may be removed for cause by the Court of Chancery in a suit by stockholders holding at least 10% of the outstanding shares of any class.

Additional directors elected pursuant to Article Fourth, Paragraph B hereof in connection with the rights to elect such additional directors under specified circumstances which may be granted to the holders of any class or series of Preferred Stock shall serve for such term or terms and pursuant to such other provisions as are specified in the resolution of the Board of Directors establishing such class or series.

NINTH: Except as may otherwise be provided pursuant to Article Fourth, Paragraph B hereof in connection with rights to elect additional directors under specified circumstances which may be granted to the holders of any class or series of Preferred Stock, newly created directorships resulting from any increase in the number of directors, or any vacancies on the Board of Directors resulting from death, resignation, removal or other causes, shall be filled solely by the affirmative vote of a majority of the remaining directors then in office, even though less than a quorum of the Board of Directors. Any director elected in accordance with the preceding sentence shall hold office for the remainder of the full term of the directorship which was newly created or as to which the vacancy occurred and until such director's successor shall have been elected and qualified or until such director's death, resignation or removal, whichever first occurs.

TENTH: Except as may otherwise be provided pursuant to Article Fourth, Paragraph B hereof in connection with rights to elect additional directors under specified circumstances which may be granted to holders of any class or series of Preferred Stock, any director may be removed from office by the affirmative vote of a majority of the voting power of all outstanding shares of stock entitled to vote in connection with the election of such director, regardless of class and voting together as a single voting class.

ELEVENTH: At any meeting of stockholders, the stockholders' vote may be by voice vote or by ballot; provided, however, that any election for directors must be by ballot if demanded by any stockholder before the voting has begun.

At a stockholders' meeting at which directors are to be elected, any stockholder shall be entitled to cumulate votes (*i.e.*, cast for any one or more candidates a number of votes greater than the number of the stockholder's shares) only if the candidates' names have been placed in nomination prior to commencement of the voting and a stockholder has given notice prior to commencement of the voting of the stockholder's intention to cumulate votes. If any stockholder has given such a notice, then every stockholder entitled to vote may cumulate votes for candidates in nomination and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which that stockholder's shares are entitled, or distribute the stockholder's votes on the same principle among any or all of the candidates, as the stockholder thinks fit. The candidates receiving the highest number of votes, up to the number of directors to be elected, shall be elected.

TWELFTH:

A. The Corporation shall indemnify to the full extent authorized or permitted by the General Corporation Law of the State of Delaware or any other applicable law as presently or hereafter in effect any person made, or threatened to be made, a defendant or witness to any action, suit or proceeding (whether civil or criminal or otherwise) by reason of the fact that he, his testator or intestate, is or was a director or officer of the Corporation or by reason of the fact that such director or officer, at the request of the Corporation, is or was serving any other corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, in any

capacity. Nothing contained herein shall affect any rights to indemnification to which employees other than directors and officers may be entitled by law. No amendment or repeal of this Paragraph A of Article Twelfth shall apply to or have any effect on any right to indemnification provided hereunder with respect to any acts or omissions occurring prior to such amendment or repeal.

B. No director of the Corporation shall be personally liable to the Corporation or its stockholders for monetary damages for any breach of fiduciary duty by such a director as a director. Notwithstanding the foregoing sentence, a director shall be liable to the extent provided by Delaware law (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) pursuant to Section 174 of the General Corporation Law of the State of Delaware, or (iv) for any transaction from which such director derived an improper personal benefit. No amendment to or repeal of this Paragraph B of Article Twelfth shall apply to or have any effect on the liability or alleged liability of any director of the Corporation for or with respect to any act or omission of such director occurring prior to such amendment or repeal.

C. In furtherance and not in limitation of the powers conferred by statute:

(1) The Corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation, or is serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the Corporation would have the power to indemnify him against such liability under the provisions of law; and

(2) The Corporation may create a trust fund, grant a security interest or use other means (including, without limitation, letters of credit, surety bonds or other similar arrangements), as well as enter into contracts providing indemnification to the full extent authorized or permitted by law and including as part thereof provisions with respect to any or all of the foregoing to ensure the payment of such amounts as may become necessary to effect indemnification as provided therein, or elsewhere.

THIRTEENTH: Special meetings of the stockholders of the Corporation. for any purpose or purposes may be called at any time by a majority of the entire Board of Directors, by the Chairman of the Board, by the President, or by one or more stockholders holding shares in the aggregate—entitled to-cast not less than 10% of the votes at the special meeting. Special meetings may not be called by any other person or persons. Each special meeting shall be held at such date and time as is requested by the person or persons calling the meeting, within the limits fixed by law.

FOURTEENTH: Meetings of stockholders of the Corporation may be held within or without the State of Delaware, as the Bylaws may provide. The books of the Corporation may be kept (subject to any provision of applicable law) outside the state of Delaware at such place or places as may be designated from time to time by the Board of Directors or in the Bylaws.

FIFTEENTH: The Corporation may make loans to or guarantee the obligations of (i) its officers or directors only if such loan or guarantee, or an employee benefit plan authorizing such loan or guarantee, is approved by the Corporation's stockholders, and (ii) to its officers only if such loan or guarantee is approved by its Board of Directors (excluding the vote of interested directors) pursuant to a stockholder-approved bylaw provision.

SIXTEENTH: The Corporation reserves the right to adopt, repeal, rescind, alter or amend in any respect any provision contained in this Restated Certificate of Incorporation in the manner now or hereafter prescribed by applicable law, and all rights conferred on stockholders herein are granted subject to this reservation.

IN WITNESS WHEREOF, the Corporation has caused this Restated Certificate of Incorporation to be executed by its duly authorized officer on this 21st day of August 2009.

ITERIS, INC.

By: /S/ JAMES S. MIELE
James S. Miele
Chief Financial Officer and Secretary

CERTIFICATE OF DESIGNATIONS
OF
SERIES A JUNIOR PARTICIPATING PREFERRED STOCK
OF
ITERIS, INC.

Pursuant to Section 151 of the
Delaware General Corporation Law

Iteris, Inc., a Delaware corporation (the “Corporation”), does hereby certify that the following resolution was adopted by the Board of Directors of the Corporation effective August 20, 2009, and such resolution has not been rescinded or amended and is in full force and effect as of the date hereof:

RESOLVED, that pursuant to the authority conferred upon the Board of Directors of Iteris, Inc., a Delaware corporation (the “Corporation”), by the provisions of the certificate of incorporation of the Corporation, as amended to date (the “Certificate of Incorporation”), there hereby is created, out of the authorized shares of undesignated Preferred Stock, a series of Preferred Stock of the Corporation consisting of One Hundred Thousand (100,000) shares, having the following designations, preferences, relative, participating, optional and other special rights, voting powers, qualifications, limitations and restrictions:

SERIES A JUNIOR PARTICIPATING PREFERRED STOCK

Section 1. Designation and Amount. The shares of such series shall be designated as “Series A Junior Participating Preferred Stock” (the “*Series A Preferred Stock*”) and the number of shares constituting such series shall be One Hundred Thousand (100,000). Such number of shares may be increased or decreased by resolution of the Board of Directors, provided that no decrease shall reduce the number of shares of Series A Preferred Stock to a number less than the number of shares then outstanding plus the number of shares reserved for issuance upon the exercise of outstanding options, rights or warrants or upon the conversion of any outstanding securities issued by the Corporation convertible into Series A Preferred Stock.

Section 2. Dividends and Distributions.

(A) Subject to the prior and superior rights of the holders of any shares of any series of Preferred Stock ranking prior and superior to the shares of Series A Preferred Stock, the holders of shares of Series A Preferred Stock, in preference to the holders of Common Stock, par value \$0.10 per share (or as such par value may be changed from time to time), of the Corporation (the "**Common Stock**") and of any other junior stock, shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available for the purpose, quarterly dividends payable in cash on or about the last day of each of March, June, September and December in each year (each such date being referred to herein as a "**Quarterly Dividend Payment Date**"), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of Series A Preferred Stock, in an amount per share (rounded to the nearest cent) equal to the greater of (i) One Dollar (\$1.00) or (ii) subject to the provision for adjustment hereinafter set forth, One Thousand (1,000) times the aggregate per share amount of all cash dividends, and One Thousand (1,000) times the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions, other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock since the immediately preceding Quarterly Dividend Payment Date or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series A Preferred Stock. If the Corporation shall at any time on or after September 3, 2009 (the "**Record Date**") declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount to which holders of shares of Series A Preferred Stock were entitled immediately prior to such event under clause (ii) of the preceding sentence shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(B) The Corporation shall declare a dividend or distribution on the Series A Preferred Stock as provided in paragraph (A) of this Section immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock); provided that, in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of \$1.00 per share on the Series A Preferred Stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(C) Dividends shall begin to accrue and be cumulative on outstanding shares of Series A Preferred Stock from the Quarterly Dividend Payment Date next preceding the date of issue of such shares of Series A Preferred Stock, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series A Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Accrued but unpaid

dividends shall not bear interest. Dividends paid on the shares of Series A Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. The Board of Directors may fix a record date for the determination of holders of shares of Series A Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be not more than 60 days prior to the date fixed for the payment thereof.

Section 3. Voting Rights. The holders of shares of Series A Preferred Stock shall have the following voting rights:

(A) Subject to the provision for adjustment hereinafter set forth, each share of Series A Preferred Stock shall entitle the holder thereof to One Thousand (1,000) votes on all matters submitted to a vote of the stockholders of the Corporation. If the Corporation shall at any time on or after the Record Date declare or pay any dividend on Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the number of votes per share to which holders of shares of Series A Preferred Stock were entitled immediately prior to such event shall be adjusted by multiplying such number by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(B) Except as otherwise provided herein, in the Certificate of Incorporation, in any other Certificate of Designations creating a series of Preferred Stock, or by law, the holders of shares of Series A Preferred Stock and the holders of shares of Common Stock and any other capital stock of the Corporation having general voting rights shall vote together as one class on all matters submitted to a vote of stockholders of the Corporation.

(C) Except as set forth herein, holders of Series A Preferred Stock shall have no special voting rights and their consent shall not be required (except to the extent they are entitled to vote with holders of Common Stock as set forth herein) for taking any corporate action.

Section 4. Certain Restrictions.

(A) Whenever quarterly dividends or other dividends or distributions payable on the Series A Preferred Stock as provided in Section 2 are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series A Preferred Stock outstanding shall have been paid in full, the Corporation shall not:

(i) declare or pay dividends on or make any other distributions on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock;

(ii) declare or pay dividends on or make any other distributions on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Preferred Stock, except dividends paid ratably on the Series A Preferred Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;

(iii) redeem or purchase or otherwise acquire for consideration shares of any stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock, provided that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such junior stock in exchange for shares of any stock of the Corporation ranking junior (either as to dividends or upon dissolution, liquidation or winding up) to the Series A Preferred Stock; or

(iv) redeem or purchase or otherwise acquire for consideration any shares of Series A Preferred Stock, or any shares of stock ranking on a parity with the Series A Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of such shares upon such terms as the Board of Directors, after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(B) The Corporation shall not permit any subsidiary of the Corporation to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (A) of this Section 4, purchase or otherwise acquire such shares at such time and in such manner.

Section 5. Reacquired Shares. Any shares of Series A Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and cancelled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued shares of Preferred Stock and may be reissued as part of a new series of Preferred Stock subject to the conditions and restrictions on issuance set forth herein, in the Certificate of Incorporation, or in any other Certificate of Designations creating a series of Preferred Stock or any similar stock or as otherwise required by law.

Section 6. Liquidation, Dissolution or Winding Up.

(A) Upon any liquidation (voluntary or otherwise), dissolution or winding up of the Corporation, no distribution shall be made to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock unless, prior thereto, the holders of shares of Series A Preferred Stock shall have received One Thousand Dollars (\$1,000.00) per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment (the “*Series A Liquidation Preference*”). Following the payment of the full amount of the Series A Liquidation Preference, no additional distributions shall be made to the holders of shares of Series A Preferred Stock unless, prior thereto, the holders of shares of Common Stock shall have received an amount per share equal to the quotient obtained by dividing (i) the Series A

Liquidation Preference by (ii) One Thousand (1,000) (as appropriately adjusted as set forth in paragraph (C) below to reflect such events as stock splits, stock dividends and recapitalizations with respect to the Common Stock) (such quotient, the “***Common Adjustment***” and the number in clause (ii), the “***Adjustment Number***”). Following the payment of the full amount of the Series A Liquidation Preference and the Common Adjustment in respect of all outstanding shares of Series A Preferred Stock and Common Stock, respectively, holders of Series A Preferred Stock and holders of shares of Common Stock shall receive their ratable and proportionate share of the remaining assets to be distributed in the ratio of the Adjustment Number to One (1) with respect to such Preferred Stock and Common Stock, on a per share basis, respectively.

(B) If, however, there are not sufficient assets available to permit payment in full of the Series A Liquidation Preference and the liquidation preferences of all other series of Preferred Stock, if any, which rank on a parity with the Series A Preferred Stock, then such remaining assets shall be distributed ratably to the holders of such parity shares (including the Series A Preferred Stock) in proportion to their respective liquidation preferences. If, after payment of the full Series A Liquidation Preference, there are not sufficient assets available to permit payment in full of the Common Adjustment, then such remaining assets shall be distributed ratably to the holders of Common Stock.

(C) If the Corporation shall at any time after the Record Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine the outstanding Common Stock into a smaller number of shares, then in each such case the Adjustment Number in effect immediately prior to such event shall be adjusted by multiplying such Adjustment Number by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

Section 7. Consolidation, Merger, Etc. If the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case the shares of Series A Preferred Stock shall at the same time be similarly exchanged or changed in an amount per share (subject to the provision for adjustment hereinafter set forth) equal to One Thousand (1,000) times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Corporation shall at any time after the Record Date declare or pay any dividend on Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount set forth in the preceding sentence with respect to the exchange or change of shares of Series A Preferred Stock shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

Section 8. **No Redemption.** The shares of Series A Preferred Stock shall not be redeemable.

Section 9. **Rank.** The Series A Preferred Stock shall rank, with respect to the payment of dividends and the distribution of assets, junior to all other series of the Preferred Stock, whether designated or issued before or after the date of this Certificate of Designations, unless the terms of any such series shall provide otherwise.

Section 10. **Fractional Shares.** The Series A Preferred Stock may be issued in fractions of a share that shall entitle the holder, in proportion to such holder's fractional shares, to exercise voting rights, receive dividends, participate in distributions and have the benefit of all other rights of holders of the Series A Preferred Stock.

Section 11. **Amendment.** The Certificate of Incorporation shall not be amended in any manner that would materially alter or change the powers, preferences or special rights of the Series A Preferred Stock so as to affect them adversely without the affirmative vote of the holders of a majority of the outstanding shares of Series A Preferred Stock.

[Remainder of Page Left Intentionally Blank]

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Designations of Series A Junior Participating Preferred Stock of Iteris, Inc. to be executed this 21st day of August 2009.

ITERIS, INC.

By: /S/ JAMES S. MIELE
James S. Miele
Chief Financial Officer and Secretary

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Abbas Mohaddes, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Iteris, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 30, 2009

/s/ ABBAS MOHADDES
Abbas Mohaddes
Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James S. Miele, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Iteris, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 30, 2009

/s/ JAMES S. MIELE

James S. Miele

Chief Financial Officer

(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Iteris, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Abbas Mohaddes, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ABBAS MOHADDES

Abbas Mohaddes
Chief Executive Officer

October 30, 2009

A signed original of this written statement required by Section 906, or any other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Iteris, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James S. Miele, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JAMES S. MIELE

James S. Miele
Chief Financial Officer

October 30, 2009

A signed original of this written statement required by Section 906, or any other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
