FORM 10-Q

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

(Mark One)
[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 1997

OR

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from___________________________ to _________________

Commission file number 0-10605

ODETICS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	95-2588496
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1515 SOUTH MANCHESTER AVE., ANAHEIM, CA 92802
(Address of principal executive offices) (Zip Code)

(714) 774-5000
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO_____

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date

Number of shares of Common Stock outstanding as of February 11, 1998

Class A Common Stock - 6,202,778 shares.
Class B Common Stock - 1,062,041 shares.

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PART 1 FINANCIAL INFORMATION

ODETICS, INC.
CONSOLIDATED STATEMENTS OF INCOME

(in thousands except per share amounts)
(Unaudited)

Three Months Ended December 31,	Nine Months Ended December 31,

	1996	1997	1996	1997
Net sales and contract revenues:				
Net sales	$18,878	$22,942	$50,961	$63,467
Contract revenues	2,018	1,362	7,291	4,415
Total net sales and contract revenue	20,896	24,304	58,252	67,882
Costs and expenses:				
Cost of sales	12,398	15,076	34,663	42,626
Cost of contract revenues	1,166	794	3,843	2,475
Selling, general and administrative expense	4,741	5,888	13,948	18,267
Research and development expense	2,017	2,352	5,629	6,661
Interest expense, net	144	175	152	291
	20,466	24,285	58,235	70,320
Income (loss) from continuing operations before taxes	430	19	17	(2,438)
Income taxes (benefit)	160	8	(39)	(975)
Net income (loss) from continuing operations	270	11	56	(1,463)
Income (loss) from discontinued operations, net of income taxes	504	(217)	2,813	2,089
Net income (loss)	$774	($206)	$2,869	$626
Earnings (loss) per common share:				
Continuing operations	$0.04	$0.00	$0.01	($0.22)
Discontinued operations	$0.08	($0.03)	$0.45	$0.31
Earnings (loss) per common share	$0.12	($0.03)	$0.46	$0.09
Earnings (loss) per common share assuming dilution:				
Continuing operations	$0.04	$0.00	$0.01	($0.22)
Discontinued operations	$0.08	($0.03)	$0.43	$0.31
Earnings (loss) per common share - assuming dilution	$0.12	($0.03)	$0.44	$0.09

See notes to consolidated financial statements.

ODETICS, INC.

CONSOLIDATED BALANCE SHEETS
(in thousands)

	March 31, 1997	Dec. 31, 1997 (unaudited)
ASSETS		
Current assets		
Cash	$1,865	$771
Trade accounts receivable, net	17,127	14,509
Current portion of ATL note receivable	3,249	3,249
Costs and estimated earnings in excess of billings on uncompleted contracts	1,922	2,028
Inventories:		
Finished goods	498	420
Work in process	2,968	3,202
Materials and supplies	12,184	13,804
Total inventories	15,650	17,426
Prepaid expenses	978	1,264
Deferred income taxes	2,798	3,223
Total current assets	43,589	42,470
Property, plant and equipment		
Land	2,090	2,090
Buildings and improvements	17,642	18,347

Equipment, furniture and fixtures	25,202	28,699
	44,934	49,136
Less accumulated depreciation	(23,824)	(26,306)
Net property, plant and equipment	21,110	22,830
Net assets of discontinued operations	8,865	0
Long term ATL note receivable less current	9,748	7,582
Other assets	2,738	11,784
Total assets	$86,050	$84,666

See notes to consolidated financial statements

ODETICS, INC.

CONSOLIDATED BALANCE SHEETS
(in thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY	March 31, 1997	Dec. 31, 1997 (unaudited)
Current liabilities		
Trade accounts payable	$ 8,802	$ 8,335
Accrued payroll and related	5,306	3,406
Accrued expenses	1,788	5,601
Income taxes payable	0	0
Billings in excess of costs and estimated earnings on uncompleted contracts	2,690	1,318
Current portion of long-term debt	1,721	1,605
Total current liabilities	20,307	20,265
Long-term debt, less current portion	11,860	16,791
Deferred income taxes	540	258
Minority Interest	1,515	---
Stockholders' equity		
Preferred stock, authorized 2,000,000 shares; none issued	-	-
Common Stock, authorized 10,000,000 shares of Class A and 2,600,000 shares of Class B; 6,202,778 shares of Class A and 1,062,041 shares of Class B issued and outstanding at December 31, 1997 - $.10 par value	638	726
Paid-in capital	38,927	46,594
Note receivable from employees	0	(3,456)
Foreign currency translation	52	60
Retained earnings	12,211	3,428
Total stockholders' equity	51,828	47,352
Total liabilities and stockholders' equity	$ 86,050	$84,666

See notes to consolidated financial statements.

ODETICS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	NINE MONTHS ENDED DECEMBER 31,	
	1996	1997
OPERATING ACTIVITIES		
Net loss from continuing operations	$56	($1,463)
Adjustments to reconcile net income to net cash provided by (used) in continuing operating activities:		
Depreciation and amortization	2,169	2,488
Provision for inventory reserves	450	822
Provision for losses on accounts receivable	99	99
Provision (benefit) for deferred income taxes	198	(282)
Net proceeds from settlement of litigation	5,860	0
Gain (loss) on sale of assets	(186)	13
Foreign currency translation gain	105	8
Changes in operating assets and liabilities	(5,758)	(5,905)
Net cash provided by (used) in continuing operating activities	2,993	(4,220)
INVESTING ACTIVITIES		
Purchases of property, plant, and equipment, net	(1,907)	(2,773)
Purchase of net assets of aquired business	0	(2,597)
Repayment of long term note receivable	(1,314)	2,166
Net cash used in investing activities	(3,221)	(3,204)
FINANCING ACTIVITIES		
Proceeds from revolving line of credit and long-term borrowings	41,940	36,051
Principal payments on line of credit, long-term debt and capital lease obligations	(44,296)	(31,236)
Proceeds from sale of common stock	1,520	1,515
Net cash provided by financing activities	(836)	6,330
Increase (decrease) in cash	(1,064)	(1,094)
Cash at beginning of year	1,142	1,865
Cash at December 31	$78	$771

See notes to consolidated financial statements.

ODETICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of normal recurring accruals except for adjustments to present the Company's former subsidiary, ATL Products, Inc. ("ATL") as a discontinued operation (See Note 4), necessary to present fairly the consolidated financial position of Odetics, Inc. (the "Company") as of December 31, 1997 and the consolidated results of operations and cash flows for the three month and nine month periods ended December 31, 1996 and 1997. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The results of operations for the three month and nine month periods ended December 31, 1997 are not necessarily indicative of those to be expected for the entire year. The accompanying financial statement should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended March 31, 1997 filed with the Securities and Exchange Commission.

Note 2 - Income Taxes

Income tax expense for the three month and nine month periods ended December 31, 1996 and 1997 have been provided at the estimated annualized effective tax rates based on the estimated income tax liability or asset and change in deferred taxes for their respective fiscal years. Deferred taxes result primarily from temporary differences in the reporting of income for financial statement and income tax purposes. These differences relate principally to the use of accelerated cost recovery depreciation methods for tax purposes, capitalization of interest and taxes for tax purposes, capitalization of computer software costs for financial statement purposes, deferred compensation, other payroll accruals, reserves for inventory and accounts receivable for financial statement purposes and general business tax credit and alternative minimum tax credit carryforwards for tax purposes.

Note 3 - Long-Term Debt

	(in thousands) March 31, 1997	December 31, 1997
Line of credit	$ 2,100	$ 8,200
Mortgage note	10,171	9,465
Contracts payable	1,310	731
	13,581	18,396
Less current portion	1,721	1,605
	$11,860	$16,791

Note 4 - On March 13, 1997, ATL completed an initial public offering of 1,650,000 shares of its Class A Common Stock, at an initial public offering price of $11 per share. Following the Offering, the Company's beneficial ownership interest in ATL was reduced to 82.9%. On October 31, 1997, the Company completed a tax-free spin-off of its remaining interest in ATL to the Company's stockholders, pursuant to which each holder of the Company's Class A and Class B Common Stock (collectively the "Common Stock") as of October 31, 1997, received approximately 1.1 shares of Class A Common Stock of ATL for each share of the Company's Common Stock then held. In connection with the spin-off, the financial statements of the Company have been restated to reflect continuing operations and the discontinued operations of ATL. The ATL net sales included in the discontinued operations for the periods being reported are as follows:

	(in thousands) December 31, 1996	December 31, 1997
Quarter Ended	$15,412	$ 5,953
Nine Months Ended	$42,452	$47,404

NOTE 5 Legal Proceedings

The Company brought an action against Storage Technology Corporation ("StorageTek") in the Eastern District Court of Virginia alleging that StorageTek had infringed the Company's patent covering robotics tape cassette handling systems (United States Patent No. 4,779,151). StorageTek counterclaimed alleging that the Company infringed several of StorageTek's patents. Prior to trial, the court dismissed two of the infringement claims against the Company and the third claim was resolved between the parties. In January 1996, the jury determined that the patent claims were not infringed under the doctrines of equivalents based upon a claim construction defined by the court prior to the trial. The jury also concluded that the Company's patent was not invalid. In June 1997, the United States Court of Appeals for the Federal Circuit vacated the lower court's claim construction and findings of noninfringement of the Company's patent. The appellate court remanded the case for consideration of infringement under a proper claim construction. In August 1997, the appellate court denied a petition for rehearing requested by StorageTek. The case has been returned to the Federal District Court for retrial.

NOTE 6 Earnings per Share

In 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, Earnings per Share. Statement 128 replaced the previously reported primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants, and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. All earnings per share amounts for all periods have been presented, and where necessary, restated to conform to the Statement 128 requirements.

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

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto contained in this Report and in the Annual Report on Form 10-K of the Company. When used in this Report, the words "expect(s)," "feel(s)," "believe(s)," "will," "may," "anticipate(s)" and similar expressions are intended to identify forward-looking statements. Such forward-looking statements include, among other things, statements concerning projected revenues, funding and cash requirements, supply issues, the Company's incubator strategy, and involve a number of risks and uncertainties, including without limitation, those set forth at the end of this Item 2 under the caption "Risk Factors." The Company's actual results may differ materially from any forward-looking statements discussed herein. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Results of Operations

General

On October 31, 1997, the Company completed the spin-off of its 82.9% interest in ATL by distributing the Company's 8,005,000 shares of Class A Common Stock to the Company's stockholders of record on October 31, 1997. In connection with the spin-off, the Company's financial statements have been restated to reflect the continuing operations and discontinued operations. Discontinued operations reflect the Company's interest in the operations of ATL for the periods presented.

Net Sales and Contract Revenues

Net sales and contract revenues consist of (i) sales of products and services to commercial customers ("net sales") and (ii) revenues derived from contracts with the agencies of the United States Government or its prime contractors and long-term contracts with foreign entities related to space recorders for geographical information systems ("contract revenues"). Total net sales and contract revenues increased 16.3% to $24.3 million for the three month period ended December 31 1997, compared to $20.9 million in the corresponding period of the prior fiscal year, and increased 16.5% to $67.9 million for the nine month period ended December 31, 1997 compared to $58.3 million in the corresponding period of the prior fiscal year. The increases in total net sales and contract revenues in both the three and nine month periods presented reflect the net impact of an increase in net sales which was offset by a decrease in contract revenues for each period presented. As the Company has continued to focus on commercial markets, it has experienced a decline in revenue contribution from agencies of the United States Government or its prime contractors, and it has experienced a decline in contract revenues relative to revenues derived from commercial customers.

Net sales increased 21.5% for the three month period ended December 31, 1997 compared to the previous fiscal year. Net sales increased 24.5% for the nine month period December 31, 1997 compared to the corresponding period of the prior fiscal year. The Company experienced

increased net sales for the three and nine month periods in its Gyyr Inc. subsidiary ("Gyyr"), its Telecom Division ("Telecom"), and its Intelligent Transportation Systems ("ITS") business. Gyyr net sales increased in the three and nine month periods of the current fiscal year largely as a result of growth in its multiplexer products and increased sales of time lapse video recorders. The increase in Gyyr sales also reflects the revenue contribution related to its acquisition of Intelligent Control Inc. ("ICI") in October 1997. The increase in the revenues of Telecom reflects increased sales of timing and synchronization products to a significant customer, LGIC of Korea. The increase in net sales in the Company's ITS business reflects the revenue contribution related to the acquisition of the transportation systems business acquired from Rockwell Inc. in the first quarter of the current fiscal year.

The increase in Gyyr, Telecom, and ITS noted above was offset by decreased sales revenue for the three and nine month periods in the Company's Broadcast Division ("Broadcast"). The decrease principally reflects softness in the demand for the Broadcast products in Asia and Latin America coupled with the delay in introduction of Broadcast's new "Roswell" product offering.

Gross Profit

Gross profit as a percentage of net sales was unchanged at 34.3% for the three months ended December 31, 1997 and 1996, and increased to 32.8% for the nine month period ended December 31, 1997 compared to 32.0% for the same period in the prior fiscal year. The Company's Gyyr subsidiary and Telecom businesses experienced improved gross profit performance in the three and nine month periods ended December 31, 1997 compared to the corresponding periods of the previous fiscal year primarily due to changes in product mix toward higher margin products, improved efficiencies gained on increased sales volume, and improved margin contribution from the acquisition of ICI by Gyyr in October 1997. Improvements in gross profit performance in Gyyr and Telecom were offset by declines in margin performance in Broadcast which resulted from an unfavorable sales mix and higher unabsorbed indirect manufacturing costs experienced on lower sales volume. Gross profit as a percentage of contract revenues decreased to 41.7% in the three months ended December 31, 1997 from 42.2% in the same period in the prior fiscal year and decreased to 43.9% for the nine month period ended December 31, 1997 compared to 47.3% in the same period in the prior fiscal year. The decrease in gross profit as a percentage of contract revenues is principally due to the lower absorption of fixed manufacturing overhead costs on decreased sales volume.

Selling, General and Administrative Expense

Selling, general and administrative expense increased 24.2% to $5.9 million (or 24.2% of total net sales and contract revenues) in the three months ended December 31, 1997 compared to $4.7 million (or 22.7% of total net sales and contract revenues) in the corresponding period of the prior fiscal year. Selling, general and administrative expense for the nine month period ended December 31, 1997 increased 31.0% to $18.3 million (or 26.9% of total net sales and contract revenues) compared to $13.9 million (or 23.9% of total net sales and contract revenues) for the same period in the prior fiscal year. The increase in selling, general, and administrative expenses in absolute dollars and as a percent of net sales and contract revenues in the three and nine months periods ended December 31, 1997 compared to the previous fiscal year periods relates primarily to investments in sales and marketing across all divisions, domestically and internationally, to support growth. The increases also relate to the acquisition of ICI and the transportation infrastructure business of Rockwell Inc. noted above. Increased spending is widely dispersed among the operating divisions and relates primarily to administrative and sales labor, sales commissions on higher sales volume, advertising and promotion to support new products and markets, and costs for international expansion incurred for Gyyr, Broadcast, Telecom, and ITS.

Research and Development Expense

Research and development expense increased 16.6% to $2.4 million (or 9.7% of total net sales and contract revenues) in the three month period ended December 31, 1997 compared to $2.0 million (or 9.7% of total net sales and contract revenues) in the corresponding period the prior fiscal year. Research and development expense for the nine month period ended December 31, 1997 increased 18.3% to $6.7 million (or 9.8% of total net sales and contract revenues) compared to $5.6 million (or 9.7% of total net sales and contract revenues) in the corresponding period of the fiscal 1997. The Company experienced increased spending to support new product development in its Gyyr, Broadcast, and Telecom operations. For competitive reasons, the Company closely guards the confidentiality of specific development projects. Spending for research and development includes both new product development as well as product line extension. The increase in new product development expenses relates primarily to development labor and related benefits, prototype material cost, and consulting fees. The acquisitions of ICI and the transportation infrastructure business of Rockwell Inc. did not materially impact the increases in current year research and development expenses. The Company expects expenditures for research and development to generally increase over time and to be higher during periods of new product development when significant expenditures are incurred in preproduction activities and increased testing. The expenditures may, therefore, continue to fluctuate as a percentage of total net sales and contract revenues from period to period.

Interest Expense

Interest Expense -net, reflects interest income and interest expense as follows:

	(in thousands)			
	Three Months Ended Dec. 31		Nine Months Ended Dec. 31	
	1996	1997	1996	1997
Interest Expense	$ 515	$ 416	$1452	$1093
Interest Income	371	241	1300	802
Interest Expense - net	$ 144	$ 175	$ 152	$ 291

Interest expense primarily reflects interest on the Company's line of credit borrowings and mortgage interest. The reduction in interest expense for the three month and nine month periods of the current fiscal year reflects a reduction in the Company's borrowings on its line of credit facility. Interest income is derived primarily from the note receivable due to the Company from ATL, its previously owned subsidiary. The reduction in interest income in the three month and nine month periods of the current fiscal year primarily reflects the $6.75 million payment by ATL in March 1997 which reduced ATL's interest bearing advances from the Company and was used to reduce the Company's borrowings under its line of credit.

Income Taxes

The Company's income tax benefit rate for the nine month period of fiscal 1998 was 40% resulting primarily from an ability to offset the loss from Odetics' continuing operation against the income of ATL during fiscal 1998 prior to its spin-off, which was effective October 31, 1997. The Company recognized a tax benefit of $39,000 for the comparable period of fiscal 1997 resulting from utilization of tax credits related to Odetics' continuing operations. The Company entered into a Tax Allocation Agreement with ATL effective April 1, 1996, pursuant to which ATL will make a payment to the Company, or the Company will make a payment to ATL, as appropriate, in an amount equal to the taxes attributable to the operations of the Company on its consolidated federal income tax returns and consolidated or combined state tax returns. In addition, the Tax Allocation Agreement provides that members of the Company's

consolidated group generating tax losses after April 1, 1996, will be paid by other members of the group which utilize such tax losses to reduce such other members' tax liability.

Liquidity and Capital Resources

On October 31, 1997, the Company completed the spin-off of its holdings in ATL (Note 4). The effect of the spin-off was to reduce total assets of the Company by $11.6 million, representing the net assets of the discontinued operations reported as of September 30, 1997.

On January 23, 1998, the Company announced its planned repurchase of up to 1.0 million shares of its common stock in the open market from time to time at prices to be determined at the time of repurchase. As of February 17, 1998, the Company had repurchased 50,000 shares pursuant to this plan, at an aggregate net cost to the Company of approximately $240,000. There can be no reassurance that the Company will repurchase the entire 1.0 million shares, and this repurchase program may be discontinued at anytime in the sole discretion of the Board of Directors.

In the nine months ended December 31, 1997, the Company incurred negative cash flow from operating activities of $4.2 million. The Company generated earnings before depreciation, amortization, and inventory reserves of $1.8 million in the first nine months of the fiscal year, and used $2.4 million in cash to fund increased inventories, and $3.9 million to pay down current liabilities (principally accounts payable). The Company has experienced improving trends with respect to inventory turnover and days sales in accounts receivable, and the negative cash flow from operating activities during the nine months ended December 31, 1997 is consistent with the operating losses incurred during the period, coupled with the aggressive investment activity of the Company's business.

The Company has a $17.0 million bank line of credit with Imperial Bank and Comerica Bank-California which provides for borrowings generally at the lessor of the bank's prime rate (8.5% at December 31, 1997) or the bank's LIBOR rate plus 2.25%. Borrowings are available for general working capital purposes, and at December 31, 1997, $8.2 million was outstanding under this line of credit, and approximately $8.5 million was available for borrowing under the line. The Company's borrowings under the line of credit are secured by substantially all of the Company's assets.

In April 1997, ATL entered into a promissory note payable to the Company in the original principal amount of $13.0 million representing the aggregate balance of ATL's interest bearing advances from the Company. This note bears interest at a rate equal to the Company's cost of borrowing (8.5% at December 31, 1997). Principal and interest on this note are payable to the Company in sixteen equal quarterly installments at the end of each calendar quarter commencing June 30, 1997.

The Company anticipates that net cash flow generated by operating activities and payments under the note receivable from ATL, together with funds available under the Company's line of credit will be adequate and enable the Company to execute its current operating plans and meet its obligations on a timely basis for at least the next twelve months.

RISK FACTORS

The Company's business is subject to a number of risks, some of which are discussed below. Other risks are presented elsewhere in this Report. The following risks should be considered carefully in addition to the other information contained in this Report in evaluating the Company and its business before purchasing the shares of the Company's Common Stock.

Fluctuations in Quarterly Operating Results. The Company has experienced wide fluctuations in quarterly and annual operating results in the past and may continue to experience fluctuations in the future based on a number of factors, not all of which are in the Company's control. These factors include, without limitation, the size and timing of significant customer orders; the introduction of new products by competitors; the availability of components used in the manufacture of the Company's products; the expenditure of substantial funds for research and development for its subsidiaries and divisions; changes in pricing policies by the Company, its suppliers or its competitors and increased price competition; the ability of the Company to develop, introduce, market and gain market acceptance of new products, applications and product enhancements in a timely manner and to control costs; the Company's success in expanding and implementing its sales and marketing programs; technological changes in the markets in which the Company operates; the reduction in revenues from government programs;

the relatively thin level of backlog at any given time; the mix of sales among the Company's channels; deferrals of customer orders in anticipation of new products, applications or product enhancements; currency fluctuations; and general economic and market conditions. Moreover, the Company's sales in any quarter typically consist of a relatively small number of large customer orders, and the timing of a small number of orders can impact quarter to quarter results. The loss of or a substantial reduction in orders from any significant customer could have a material adverse effect on the Company's business, financial condition and results of operations. The Company's growth in revenues in recent periods may not be sustainable and may not be indicative of future operating results, and there can be no assurance that the Company will continue to achieve profitability on a quarterly or annual basis in the future. Due to all of the foregoing factors and other risks discussed below, it is possible that in some future period the Company's operating results may be below the expectations of analysts and investors. In such event, the market price of the Company's securities would probably be materially and adversely affected.

Dependence on Sole Source Suppliers. The Company purchases numerous parts, supplies and other components used in its products from various independent suppliers, some of whom are the sole supplier for certain parts and components. In particular, the Company currently relies on single supplier for the principal component of the Gyyr's time-lapse videotape cassette recorders. The Company has not been able to secure any guarantee of the future supply of its sole sourced components. The disruption or termination of the supply of any of the Company's source sourced components for any reason would have a material adverse effect on the Company's business, financial condition and results of operations.

Uncertainty of Incubator Strategy. The Company has initiated a strategy to nurture its business divisions with the goal of conducting additional initial public offerings. The Company's ability to complete an initial public offering of any of its divisions will depend upon numerous factors, including, without limitation, the overall performance of such division, its growth potential, management team, market size, customer base, product line and results of operations, as well as general economic and market conditions. There can be no assurance that the Company will be able to complete a successful initial public offering of any of its divisions in the near future, if at all.

Rapid Technological Change; Effect of New Product Introductions. The markets served by the Company are characterized by rapid technological advances, downward price pressure in the marketplace as technologies mature, changes in customer requirements, frequent new product introductions and enhancements, and evolving industry standards. The Company's business requires substantial ongoing research and development efforts and expenditures, and its future success will depend on its ability to enhance its current products, reduce product costs and develop and introduce new products which incorporate the latest technological advancements in hardware, storage media, operating system software and applications software in response to evolving customer requirements. The Company's failure to anticipate or respond adequately to technological developments and changing customer requirements, the occurrence of significant delays in new product development or introduction or the failure of any new products to gain market acceptance could impair the Company's competitiveness and could materially and adversely affect the Company's business, financial condition and results of operations. There can be no assurance that the Company will be able to introduce new products or enhancements to existing products on a timely basis, if at all, or the effect to which such introductions will have on sales of existing products. To the extent new products are introduced, they may contain undetected design faults and software errors, or "bugs," when first released by the Company that, despite testing by the Company, are discovered only after a product has been installed and used by customers. Although the Company has not experienced any material adverse effect resulting from any such faults or errors to date, there can be no assurance that faults or errors in the Company's existing products or in new products introduced by the Company will not be discovered in the future, causing delays in product introduction and shipments or requiring design modifications that could adversely affect the Company's competitive position and results of operations.

Competition. The Company competes in each of its markets with numerous other companies, many of which have far greater name recognition and financial, technological, marketing and customer service resources than the Company and may be able to respond more quickly to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, promotion, sale and support of their products than the Company. The principal competitive factors in the markets in which the Company participates are product quality and performance, price, reliability, upgradeability, service and technical support. There can be no assurance that the Company will be able to compete effectively in the markets for its products. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any of which could have a material adverse affect upon the Company's business, operating results and financial condition.

Risks Associated with International Sales. International product sales represented approximately 36% and 33% of the Company's total net sales and contract revenues during the first nine months of fiscal 1997 and 1998, respectively. The Company's products sold by its Telecom operations are sold principally to LGIC of Korea. As a result of economic uncertainty in Asia, particularly Korea, the Company's sales in the region could be subject to decline. The Company believes that international sales will continue to represent a significant portion of its revenues, and that continued growth and profitability will require further expansion of its international operations. The Company's international sales are currently denominated primarily in U.S. dollars, and an increase in the relative value of the dollar could make the Company's products more expensive and, therefore, potentially less price competitive in international markets. Additional risks inherent in international business activities generally include unexpected changes in regulatory requirements, tariffs and other trade barriers, longer accounts receivable payment cycles, difficulties in managing and staffing international operations, potentially adverse tax consequences including restrictions on the repatriation of earnings, the burdens of compliance with a wide variety of foreign laws, currency fluctuations and political and economical instability. The Company does not engage in any transactions as a hedge against risks of loss due to foreign currency fluctuations. There can be no assurance that such factors will not have a material adverse effect on the Company's future

international sales and, consequently, the Company's business, operating results and financial condition. Furthermore, as the Company increases its international sales, its 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.

Dependence on Key Personnel. The Company's future performance depends to a significant extent on its senior management and other key employees, in particular Joel Slutzky, the Company's Chief Executive Officer. The loss of the services of Mr. Slutzky or certain key employees would have a material adverse effect on the Company's development and marketing efforts. The Company's future success will also depend in large part upon its ability to attract, retain and motivate highly skilled employees. Competition for employees, particularly development engineers, is intense, and there can be no assurance that the Company will be able to continue to attract and retain sufficient numbers of such highly skilled employees. The Company's inability to attract and retain additional key employees or the loss of one or more of its current key employees could have a material adverse effect upon the Company's business, financial condition, and results of operations.

Dependence on Proprietary Technology; Risks of Infringement. The Company's ability to compete effectively depends in part on its ability to develop and maintain proprietary aspects of its technology which the Company attempts to protect with a combination of patent, copyright, trademark and trade secret laws, employee and third party nondisclosure agreements and similar means. Such rights may not preclude competitors from developing substantially equivalent or superior products to the Company's products. In addition, the laws of some foreign countries do not protect the Company's proprietary rights as fully as do the laws of the United States. There can be no assurance that the Company's means of protecting its proprietary rights in the United States or abroad will be adequate, that future patents will be issued, or that competitors will not independently develop technologies that are similar or superior to the Company's technology, duplicate the Company's technology, or design around any patent of the Company. Moreover, litigation has been necessary in the past and may be necessary in the future to enforce the Company's intellectual property rights, to determine the validity and scope of the proprietary rights of others, or to defend the Company against claims of infringement or invalidity by others. An adverse outcome in such litigation or similar proceedings could subject the Company to significant liabilities to third parties, require disputed rights to be licensed from others or require the Company to cease marketing or using certain products, any of which could have a material adverse effect on the Company's business, financial condition and results of operations. If the Company is required to obtain licenses under patents or proprietary rights of others, there can be no assurance that any required licenses would be made available on terms acceptable to the Company, if at all. In addition, the cost of addressing any intellectual property litigation claim, both in legal fees and expenses and the diversion of management resources, regardless of whether the claim is valid, could be significant and could have a material adverse effect on the Company's results of operations.

Volatility of Stock Price. The trading price of the Company's Common Stock could be subject to wide fluctuations in response to quarterly variations in operating results, shortages announced by suppliers, announcements of technological innovations or new products, applications or product enhancements by the Company or its competitors, changes in financial estimates by securities analysts and other events or factors. In addition, the stock market has experienced volatility which has particularly affected the market prices of equity securities of many high technology companies and which often has been unrelated to the operating performance of such companies. These broad market fluctuations may adversely affect the market price of the Company's securities.

Concentration of Ownership. As of October 31, 1997, the Company's officers and directors beneficially owned a majority of the total combined voting power of the outstanding shares of Class A Common Stock and Class B Common Stock. As a result of their stock ownership, management will be able to significantly influence the election of the Company's directors and the outcome of

corporate actions requiring stockholder approval, such as mergers and acquisitions, regardless of how other stockholders of the Company may vote. This concentration of voting control may have a significant effect in delaying, deferring or preventing a change in management or change in control of the Company and may adversely affect the voting or other rights of other holders of Common Stock.

Anti-Takeover Effect of Charter Provisions, Bylaws, and Stock Structure. The Company has two classes of Common Stock which are substantially identical other than with respect to voting power. The Company's Class A Common Stock entitles the holder to 1/10th vote per share and Class B

Common Stock entitles the holder to one vote per share, with concentration of ownership of the Class B Common Stock in the Company's officers and directors and their affiliates. In addition, the Company's Board of Directors is elected annually on a split vote basis, with the holders of Class A Common Stock currently being entitled to elect two of the directors and holders of the Class B Common Stock currently being entitled to elect the remaining six directors. These provisions could have the effect of discouraging a proxy contest or making it more difficult for a third party acquiring a substantial block of the Company's Common Stock to effect a change in management and control of the Company. Such provisions also could limit the price that investors might be willing to pay in the future for shares of the Company's Common Stock.

The Board of Directors of the Company is authorized to issue, without stockholder approval, up to 2,000,000 shares of Preferred Stock with voting, conversion and other rights and preferences, as well as additional shares of Class B Common Stock, which could adversely affect the voting power or other rights of the holders of Class A Common Stock. Although the Company has no current plans to issue any shares of Preferred Stock or additional shares of Class B Common Stock, the future issuance of Preferred Stock or Class B Common Stock or of rights to purchase Preferred Stock or Class B Common Stock could be used to discourage an unsolicited acquisition proposal.

Year 2000 Compliance. Many currently installed computer systems and software products are coded to accept only two digit entries in the date code field. These date code fields will need to accept four digit entries to distinguish 21st century dates from 20th century dates. As a result, in less than three years, computer systems and/or software used by many companies may need to be upgraded to comply with such "Year 2000" requirements. Significant uncertainty exists in the hardware and software industry concerning the potential effects associated with such compliance. Although the Company's core products are designed to be Year 2000 compliant, there can be no assurance that such products contain all necessary date code changes. The Company is exploring changes to its existing information systems to become Year 2000 compliant. The Company will be required to expend additional resources to make such corrections to its products and information systems, which corrections may not be able to be made on a timely basis, if at all. The Company believes that the purchasing patterns of customers and potential customers may be affected by Year 2000 issues in a variety of ways. Many companies are expending significant resources to correct or patch their current systems for Year 2000 compliance. These expenditures may result in reduced funds available to purchase products such as those offered by the Company. Many potential customers may also choose to defer purchasing Year 2000 compliant products until they believe it is absolutely necessary, thus resulting in potentially stalled market sales within the industry. In addition, Year 2000 issues could cause a significant number of companies, including current customers of the Company, to reevaluate their current system needs, and as a result consider switching to other systems or suppliers. Any of the foregoing could result in a material adverse effect on the Company's business financial condition and results of operation.

PART II OTHER INFORMATION

Item 1.   LEGAL PROCEEDINGS

The Company brought an action against Storage Technology Corporation ("StorageTek") in the Eastern District Court of Virginia alleging that StorageTek had infringed the Company's patent covering robotics tape cassette handling systems (United States Patent No. 4,779,151).

StorageTek counterclaimed alleging that the Company infringed several of StorageTek's patents. Prior to trial, the court dismissed two of the infringement claims against the Company and the third claim was resolved between the parties. In January 1996, the jury determined that the patent claims were not infringed under the doctrine of equivalents based upon a claim construction defined by the court prior to the trial. The jury also concluded that the Company's patent was not invalid. In June 1997, the United States Court of Appeals for the Federal Circuit vacated the lower court's claim construction and findings of noninfringement of the Company's patent. The appellate court remanded the case for consideration of infringement under a proper claim construction. In August 1997, the appellate court denied a petition for rehearing requested by StorageTek. The case has been returned to the Federal District Court for retrial.

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

NONE

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

27. Financial Data Schedule

(b) Reports on Form 8-K

There were no reports on Form 8-K filed for the nine month period ended December 31, 1997.

ODETICS, INC.

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.

ODETICS, INC.
(Registrant)

By /s/ Gregory A. Miner

Gregory A. Miner
Vice President, Chief Financial Officer

By /s/ Gary Smith

Gary Smith
Vice President, Controller
(Principal Accounting Officer)

Date February 17, 1998

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