

ITERIS, INC.  
Form 10-Q  
February 13, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**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 December 31, 2008

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)

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**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)**



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





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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, 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



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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

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

Accelerated filer

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



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As of February 4, 2009, the registrant had 34,186,756 shares of common stock outstanding.

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**ITERIS, INC.**

**Quarterly Report on Form 10-Q  
For the Three and Nine Months Ended December 31, 2008**





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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.

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**



**ITERIS, INC.**



**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except par value amounts)

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	December 31, 2008 (unaudited)	March 31, 2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 5,975	\$ 421
Trade accounts receivable, net of allowance for doubtful accounts of \$782 and \$1,020 at December 31, 2008 and March 31, 2008, respectively	12,850	13,108
Costs and estimated earnings in excess of billings on uncompleted contracts	3,369	5,351
Inventories, net of reserve for inventory obsolescence of \$968 and \$819 at December 31, 2008 and March 31, 2008, respectively	4,997	4,226
Deferred income taxes	841	2,541
Prepaid expenses and other current assets	292	371
Total current assets	28,234	26,018
Property and equipment, net	3,428	3,467
Deferred income taxes	7,807	7,807
Intangible assets, net	147	257
Goodwill	27,774	27,774
Other assets	211	322
Total assets	\$ 67,691	\$ 65,645
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Trade accounts payable	\$ 3,272	\$ 3,902
Accrued payroll and related expenses	3,291	3,825
Accrued liabilities	1,873	1,973
Billings in excess of costs and estimated earnings on uncompleted contracts	1,790	1,126
Current portion of long-term debt	2,191	244
Total current liabilities	12,417	11,070
Deferred rent	1,752	1,956
Unrecognized tax benefits	1,098	1,381
Other non-current liabilities	37	461
Long-term debt	5,114	7,566
Total liabilities	20,418	22,434
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$1.00 par value, 2,000 shares authorized, none issued and outstanding at December 31, 2008 and March 31, 2008		
Common stock, \$0.10 par value, 70,000 shares authorized, 34,182 and 33,420 shares issued and outstanding at December 31, 2008 and March 31, 2008, respectively	3,418	3,342
Additional paid-in capital	136,887	135,516
Common stock held in trust, 24 and 167 shares at December 31, 2008 and March 31, 2008, respectively	(31)	(202)
Accumulated deficit	(93,025)	(95,499)
Accumulated other comprehensive income	24	54
Total stockholders' equity	47,273	43,211
Total liabilities and stockholders' equity	\$ 67,691	\$ 65,645

See accompanying notes to unaudited condensed consolidated financial statements.





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**ITERIS, INC.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**



(In thousands, except per share amounts)

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	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
<b>Net sales and contract revenues:</b>				
Net sales	\$ 9,083	\$ 9,176	\$ 30,687	\$ 30,215
Contract revenues	7,379	6,187	22,283	17,881
Total net sales and contract revenues	16,462	15,363	52,970	48,096
<b>Costs of net sales and contract revenues:</b>				
Cost of net sales(a)	4,890	4,631	16,043	15,302
Cost of contract revenues(a)	5,068	4,232	14,796	11,938
Gross profit	6,504	6,500	22,131	20,856
<b>Operating expenses:</b>				
Selling, general and administrative(a)	4,385	4,331	14,193	13,119
Research and development(a)	848	1,002	3,180	2,623
Amortization of intangible assets	37	37	110	110
Total operating expenses	5,270	5,370	17,483	15,852
Operating income	1,234	1,130	4,648	5,004
<b>Non-operating income (expense):</b>				
Other income, net	63	(3)	90	41
Interest expense, net	(141)	(314)	(537)	(1,046)
Income before income taxes	1,156	813	4,201	3,999
Income tax benefit (provision)	(415)	141	(1,727)	221
Net income	\$ 741	\$ 954	\$ 2,474	\$ 4,220
<b>Earnings per share:</b>				
Basic	\$ 0.02	\$ 0.03	\$ 0.07	\$ 0.13
Diluted	\$ 0.02	\$ 0.03	\$ 0.07	\$ 0.12
<b>Weighted average shares outstanding:</b>				
Basic	34,120	32,914	33,895	32,568
Diluted	34,358	35,256	34,752	34,674

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

Cost of net sales	\$ 2	\$ 1	\$ 7	\$ 3
Cost of contract revenues	10	3	30	9
Selling, general and administrative	75	77	228	190
Research and development	5	1	15	5
Total	\$ 92	\$ 82	\$ 280	\$ 207

See accompanying notes to unaudited condensed consolidated financial statements.

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**ITERIS, INC.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

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	Nine Months Ended December 31,	
	2008	2007
<b>Cash flows from operating activities</b>		
Net income	\$ 2,474	\$ 4,220
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in deferred tax assets	1,700	(229)
Depreciation and amortization of property and equipment	755	443
Stock-based compensation expense	280	207
Amortization of debt discount	166	155
Amortization of intangible assets	110	110
Amortization of deferred financing costs	110	104
Amortization of deferred gain on sale leaseback transaction		(165)
Changes in operating assets and liabilities:		
Accounts receivable	258	(1,114)
Net costs and estimated earnings in excess of billings	2,646	(1,108)
Inventories	(771)	1,979
Prepaid expenses and other assets	80	(166)
Accounts payable and accrued liabilities	(1,778)	928
Net cash provided by operating activities	6,030	5,364
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(716)	(455)
<b>Cash flows from financing activities</b>		
Proceeds from stock option and warrant exercises	911	1,325
Borrowings on long-term debt	5,073	
Payments on long-term debt	(5,744)	(1,727)
Net payments on line of credit		(3,816)
Change in checks drawn in excess of available bank balances		(47)
Net cash provided by (used in) financing activities	240	(4,265)
Increase in cash	5,554	644
Cash at beginning of period	421	35
Cash at end of period	\$ 5,975	\$ 679
<b>Supplemental cash flow information:</b>		
Cash paid during the period:		
Interest	\$ 435	\$ 825
Income taxes	404	48
<b>Supplemental schedule of non-cash investing and financing activities:</b>		
Fair value of common stock issued in settlement of liabilities	\$ 427	\$ 350
Conversion of redeemable common stock to common stock		3,414
Lease incentives in connection with new headquarters lease		1,772
Write-off of notes receivable from employees		(5)

See accompanying notes to unaudited condensed consolidated financial statements.







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**ITERIS, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2008

## 1. Description of Business and Summary of Significant Accounting Policies

### Description of Business

Iteris, Inc. is 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. By combining outdoor image processing, traffic engineering and information technology, the Company offers a broad range of Intelligent Transportation Systems ( ITS ) and driver safety solutions to customers worldwide. As an added benefit, the Company's products and services minimize the environmental impact of traffic congestion. The Company was originally incorporated in Delaware in 1987.

### Basis of Presentation

The unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States 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 the Company as of December 31, 2008, the consolidated results of operations for the three and nine months ended December 31, 2008 and 2007, and the consolidated cash flows for the nine months ended December 31, 2008 and 2007. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ( 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 nine months ended December 31, 2008 are not necessarily indicative of those to be expected for the entire year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended March 31, 2008, which was filed with the SEC on June 12, 2008.

### Use of Estimates



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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, 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.

### **Reclassifications**

Certain amounts in the prior period financial statements have been reclassified to conform with current year presentation.

### **Revenue Recognition**



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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 the Company believes 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.



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In addition to product and contract revenue, the Company derives 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 the Company's products. Non-recurring contract engineering revenues and royalty revenues are included in net sales in the accompanying condensed consolidated statements of operations.

Revenues from follow-on service and support, for which the Company charges separately, are recorded in the period in which the services are performed.

**Concentration of Credit Risk**

Accounts receivable are primarily derived from revenues earned from customers located throughout North America and Europe. The Company generally does 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 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 values of cash and cash equivalents, receivables, inventories, accounts payable and accrued expenses approximate carrying value because of the short period of time to maturity. The fair values of line of credit agreements and long-term debt approximate carrying value because the related rates of interest approximate current market rates. The fair value of convertible debentures approximates carrying value because the effective interest rate, taking into account recorded debt discounts, approximates current market rates.

**Inventories**



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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

In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Intangible Assets*, goodwill is tested for impairment on an annual basis in the Company's fourth fiscal quarter or more frequently if indicators of impairment exist, of which none have been identified. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of the Company's reporting units with each respective reporting unit's carrying amount, including goodwill. The Company determines 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.

The Company evaluates long-lived assets for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which requires impairment evaluation on long-lived assets used in operations 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 the Company's 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

The Company utilizes the liability method of accounting for income taxes as set forth in SFAS No. 109, *Accounting for Income Taxes* ( SFAS 109 ). Under the liability method, 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.

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**Stock-Based Compensation**

Effective April 1, 2006, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123R ), which requires all stock-based payments, including grants of employee stock options, to be recognized in the statement of operations as an expense, based on their grant date fair values with such fair values amortized over the requisite service period. The Company elected to use the modified prospective transition method for transition to SFAS 123R. Under the modified prospective method, SFAS 123R applies to all awards granted or modified after the date of adoption. In addition, under the modified prospective method, compensation expense is recognized for all stock-based compensation awards granted prior to but not yet vested as of April 1, 2006, based on grant-date fair values estimated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*.

The fair value of the Company's common stock option awards is estimated on the grant date using the Black-Scholes-Merton ( BSM ) option-pricing formula. Expected volatility is based on the historical volatility of the Company's stock price. The expected life of options granted subsequent to the adoption of SFAS 123R is derived based on the historical life of the Company's options. The risk-free interest rate for periods within the expected life of the option is based on the U.S. Treasury interest rates in effect at the time of grant.

**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**

The Company generally provides 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

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repaired or replaced, generally at the Company's option, upon meeting certain criteria. The Company accrues 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 expenses on the accompanying condensed consolidated balance sheets.

### **Repair and Maintenance Costs**

The Company incurs repair and maintenance costs in the normal course of business. Should the activity result in a permanent improvement to one of the Company's 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 September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value measurements. SFAS 157 does not require any new fair value measurements; rather it specifies valuation methods to be applied when fair value measurements are required under existing or future accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those

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fiscal years. In February 2008, the FASB issued FASB Staff Position ( FSP ) 157-2, *Effective Date of FASB Statement No. 157* ( FSP 157-2 ), which delays the effective date of SFAS 157 for non-financial assets and liabilities to fiscal years beginning after November 15, 2008. Generally, SFAS 157 will be applied prospectively. With respect to financial assets and liabilities, the Company adopted SFAS 157 in the first quarter of fiscal 2009. There was no material impact on the consolidated financial statements. The Company is currently evaluating the impact of SFAS 157 and FSP 157-2 with respect to its non-financial assets and liabilities and expects to adopt SFAS 157 and FSP 157-2 with respect to these assets and liabilities in the first quarter of its fiscal year ending March 31, 2010.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement of certain financial assets and liabilities on a contract-by-contract basis. Subsequent changes in fair value of these financial assets and liabilities would be recognized in earnings when they occur. SFAS 159 is effective for fiscal years beginning after November 15, 2007 with earlier adoption permitted under special rules. The adoption of SFAS 159 did not have a material impact on the consolidated financial statements of the Company.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* ( SFAS 141R ). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. The nature and magnitude of the specific effects of adopting SFAS 141R will depend upon the nature, terms and size of any acquisitions the Company may consummate after the effective date of the Company's adoption of SFAS 141R (April 1, 2009).

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS 162 ). SFAS 162 identifies the sources of accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP. SFAS 162 is effective 60 days following the SEC approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Company currently adheres to the hierarchy of U.S. GAAP as presented in SFAS 162, and adoption is not expected to have a material impact on its consolidated financial statements.

In June 2008, the FASB issued Emerging Issues Task Force ( EITF ) Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* ( EITF 07-5 ). EITF 07-5 clarifies how to determine whether certain instruments or features were indexed to an entity's own stock under EITF Issue No. 01-6, *The Meaning of Indexed to a Company's Own Stock*, ( EITF 01-6 ) and provides guidance to determine what accounting literature may apply to a particular equity linked instrument or feature. EITF 07-5 will become effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and must be applied to all instruments outstanding on the date of adoption. The Company is currently evaluating the impact of EITF 07-5, and has not yet determined the effect, if any, of its adoption on the Company's consolidated financial statements.

**2. Supplemental Financial Information**

**Inventories**

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The following table presents details of the Company's inventories:

	December 31, 2008	March 31, 2008
	(In thousands)	
Materials and supplies	\$ 4,152	\$ 3,031
Work in process	16	345
Finished goods	829	850
	\$ 4,997	\$ 4,226

**Intangible Assets**

	December 31, 2008		March 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Developed technology	\$ 495	\$ (457)	\$ 495	\$ (381)
Patents	317	(208)	317	(174)
Total	\$ 812	\$ (665)	\$ 812	\$ (555)

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Amortization expense for intangible assets subject to amortization was \$37,000 and \$110,000 for the three and nine months ended December 31, 2008, respectively, and \$37,000 and \$110,000 for the three and nine months ended December 31, 2007, respectively. Future estimated amortization expense for the remainder of the current fiscal year and the next three fiscal years is as follows:

**Fiscal Year Ending March 31:**

(In thousands)

Remainder of 2009	\$	37
2010		58
2011		46
2012		6
	\$	147

**Warranty Reserve Activity**

The following table presents activity in accrued warranty obligations:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
	(In thousands)			
Balance at beginning of period	\$ 557	\$ 489	\$ 494	\$ 520
Additions charged to cost of sales	74	109	258	253
Warranty claims	(75)	(74)	(196)	(249)
Balance at end of period	\$ 556	\$ 524	\$ 556	\$ 524

**Earnings Per Share**

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
	(In thousands, except per share amounts)			
<b>Numerator:</b>				
Net income	\$ 741	\$ 954	\$ 2,474	\$ 4,220
<b>Denominator:</b>				
Weighted average common shares used in basic computation	34,120	32,914	33,895	32,568
Dilutive stock options	238	2,329	853	2,086



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Dilutive warrants		13		4		20
Weighted average common shares used in dilutive computation		<b>34,358</b>	35,256	<b>34,752</b>		34,674
Earnings per share:						
Basic	\$	<b>0.02</b>	\$	0.03	\$	<b>0.07</b>
Diluted	\$	<b>0.02</b>	\$	0.03	\$	<b>0.07</b>
					\$	0.13
					\$	0.12

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
	(In thousands)			
Stock options	<b>2,184</b>	355	<b>1,245</b>	552
Warrants	<b>1,165</b>	1,150	<b>1,155</b>	1,177
Convertible debentures	<b>623</b>	2,729	<b>1,639</b>	2,729

Table of Contents**3. Revolving Line of Credit and Long-Term Debt****Revolving Line of Credit**

Prior to October 16, 2008, the Company had a credit facility with a bank that provided for line of credit borrowings of up to \$10.0 million. Under this credit facility, the Company could borrow against its eligible accounts receivable and eligible inventory, as defined in the credit agreement. Interest on borrowed amounts under the line of credit was payable monthly at the current stated prime rate plus 1.00%. Additionally, the Company was obligated to pay an unused line fee of 0.25% per annum applied to the amount by which the maximum credit amount exceeded the average daily principal balance during the preceding month. The credit facility required \$2,000 in monthly collateral management fees and included an early termination fee equal to 2% of the total facility during the first year of the agreement and 1% of the total facility in the second year of the agreement. The credit facility was secured by substantially all of the assets of the Company. This credit facility expired on October 15, 2008.

Effective October 16, 2008, the Company entered into a new \$19.5 million credit facility with a different bank which replaced the Company's existing credit facility. This new credit facility 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 will be 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 December 31, 2008). The Company is obligated to pay an unused line fee of 0.25% per annum applied to the average unused portion of the \$12.0 million 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 the assets of the Company. As of December 31, 2008, no amounts were borrowed under the revolving line of credit portion of the facility. As part of this new credit facility, the Company may also borrow up to \$7.5 million in the form of a 48-month term note to retire its convertible debentures as discussed below under Long-Term Debt Bank Term Notes .

**Long-Term Debt**

The Company's long-term debt consists of the following:

	December 31, 2008	March 31, 2008
	(In thousands)	
Convertible debentures, net	\$ 2,232	\$ 7,566
Bank term notes	5,073	210
Other		34
	7,305	7,810
Less current portion	(2,191)	(244)
	\$ 5,114	\$ 7,566

*Convertible Debentures, Net.* In May 2004, the Company sold and issued subordinated convertible debentures in the aggregate original principal amount of \$10.1 million. In connection with the issuance of the debentures, the Company

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issued warrants to purchase an aggregate of 639,847 shares of its common stock, the value of which was recorded as a debt discount against the face amount of the debentures on the date of issuance and is being amortized to interest expense over the term of the convertible debentures.

The debentures are due in full on May 18, 2009, provide for 6.0% annual interest, payable quarterly, and are convertible into the Company's common stock at an initial conversion price of \$3.61 per share, subject to certain adjustments, including adjustments for dilutive issuances. From May 19, 2008 until the maturity date, the Company may redeem the debentures at 110% of the principal amount. As of December 31, 2008, \$250,000 of debentures had been converted into 69,252 shares of the Company's common stock.

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Additionally, as of December 31, 2008, the Company had retired \$7.6 million of its outstanding debentures, at the holders' request, using \$2.1 million in cash and \$5.07 million financed under the Company's new bank term note, which is described below under the caption "Bank Term Notes." In January 2009, the Company paid \$1.47 million to retire an additional \$1.5 million of debentures, at the holders' request, leaving \$750,000 of debentures outstanding. The \$1.47 million was also financed under the Company's new bank term note. In accordance with SFAS No. 6, *Classifications of Short-Term Obligations Expected to Be Refinanced*, the Company has classified the long-term portion of the debentures financed under the new term note subsequent to December 31, 2008 as long-term debt in the accompanying condensed consolidated balance sheet.

*Bank Term Notes.* In October 2004, the Company entered into a \$5.0 million term note payable with a bank. The note was due on May 27, 2008, and provided for monthly principal payments of approximately \$104,000. The final payment against this term note was made in June 2008.

Effective October 16, 2008, the Company entered into a new \$19.5 million credit facility with a different bank, as described above. Under this new credit facility, the Company may borrow up to \$7.5 million in the form of a 48-month term note to retire all outstanding convertible debentures. Principal payments under this term note are required to be repaid in 48 monthly installments commencing on June 1, 2009. Interest on the term note will be 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 December 31, 2008). The Company paid an upfront loan commitment fee of \$28,000 for the term note. The term note contains no early termination fees and, along with the new revolving line of credit under the same credit agreement (above), is secured by substantially all of the assets of the Company. As of December 31, 2008, \$5.07 million had been borrowed against this term note to repay debentures. In January 2009, an additional \$1.47 million was borrowed for the same purpose; increasing the total amount borrowed under the term note to \$6.5 million as of February 6, 2009.

On February 4, 2009 the Company entered into an Amended and Restated Loan and Security Agreement with its current senior lender which supersedes the agreements entered into on October 16, 2008 in their entirety. The October 16, 2008 documents were amended and restated to clarify the meaning of certain ambiguities and remove non-applicable language. No modifications were made to any significant provisions related to the overall amount of the credit facility, interest rate calculations, or any financial or non-financial covenant.

Scheduled aggregate maturities of long-term debt principal as of December 31, 2008, were as follows:

**Fiscal Year Ending March 31,  
(In thousands)**

2009	\$	
2010		2,620
2011		2,144
2012		2,144
2013		415
Thereafter		7,323
Less: unamortized debt discount		(18)
	\$	7,305

**4. Commitments and Contingencies**

**Litigation and Other Contingencies**

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

Furthermore, from time to time, the Company has experienced unforeseen developments in contingencies related to its former subsidiaries. For example, the Company has been the subject of a number of routine tax audits for time periods and jurisdictions related to the businesses of its 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, management does not believe that the Company is presently involved in any matters related to its former subsidiaries that would have a material adverse effect on the Company's consolidated results of operations, financial position or cash flows.

Table of Contents**Operating Lease Commitments**

The Company has lease commitments for facilities in various locations throughout the United States. Future commitments under these non-cancelable operating leases at December 31, 2008 were as follows:

<b>Fiscal Year Ending March 31,</b>	
<b>(In thousands)</b>	
Remainder of 2009	\$ 812
2010	1,661
2011	1,444
2012	1,365
2013	1,380
Thereafter	2,460
<b>Total</b>	<b>\$ 9,122</b>

The Company previously subleased office space to MAXxess Systems, Inc. ( MAXxess ), a former subsidiary of the Company that was sold by the Company in September 2003 and is currently owned by an investor group that includes four of the Company's directors, one of whom is the Chief Executive Officer of MAXxess. At December 31, 2008, MAXxess owed the Company an aggregate of \$274,000 related to this sublease, which terminated in September 2007, and certain related ancillary services that were previously provided by the Company to MAXxess. Although the Company has fully reserved for amounts owed to it by MAXxess under the terms of this sublease, the Company plans to continue to pursue full payment of any and all amounts due from MAXxess, but cannot assure that MAXxess will be able to make such payments.

**Inventory Purchase Commitments**

At December 31, 2008, the Company had firm commitments to purchase inventory in the amount of approximately \$2.5 million during the next three fiscal quarters.

**5. Stock-Based Compensation**

Under the Company's 2007 Omnibus Incentive Plan (the 2007 Plan), options to purchase shares of the Company's unissued common stock may be granted to the Company's employees, officers, consultants and directors at exercise prices which are equal to or greater than the fair market value of the Company's common stock on the date of grant. Options expire no more than ten years after the date of grant and generally vest at the rate of 25% on each of the first four anniversaries of the grant date. The 2007 Plan also allows for the issuance of stock appreciation rights, restricted stock, restricted stock units and other stock-based awards. New shares are issued to satisfy stock option exercises and share issuances under the 2007 Plan. As of December 31, 2008, options to purchase an aggregate of 404,000 shares of common stock were outstanding under the 2007 Plan.

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The Company's 1997 Stock Incentive Plan (the "1997 Plan") terminated in September 2007; however, all stock options outstanding under the 1997 Plan will remain outstanding pursuant to the terms of such stock options. As of December 31, 2008, options to purchase approximately 1.3 million shares of the Company's common stock were outstanding under the 1997 Plan.

In connection with the October 2004 merger of the Company and its previously majority-owned subsidiary, Iteris Inc. (the "Iteris Subsidiary"), the Company assumed the 1998 Stock Incentive Plan of the Iteris Subsidiary (the "1998 Plan") and all outstanding options granted thereunder. As of December 31, 2008, options to purchase approximately 1.8 million shares of the Company's common stock were outstanding under the 1998 Plan. The 1998 Plan has been terminated and no further options may be granted under the 1998 Plan.

Certain options granted under the 2007 Plan, the 1997 Plan and the 1998 Plan (collectively, the "Plans") provide for accelerated vesting of unvested options in the event of a change in control under certain circumstances. These change-in-control provisions meet the criteria of a performance condition under SFAS 123R.

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A summary of activity in the Plans for the nine months ended December 31, 2008 is as follows:

	Options	Weighted Average Exercise Price (In thousands, except number of years)	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Options outstanding at March 31, 2008	4,524	\$ 1.83	3.7	
Granted	30	2.10	N/A	
Exercised	(762)	1.20	N/A	
Forfeited	(18)	2.59	N/A	
Expired	(303)	2.53	N/A	
Options outstanding at December 31, 2008	3,471	\$ 1.91	4.1	\$ 1,781
Vested and expected to vest at December 31, 2008	3,381	\$ 1.90	4.0	\$ 1,781
Options exercisable at December 31, 2008	2,949	\$ 1.82	3.4	\$ 1,781
Options exercisable at December 31, 2008 pursuant to a change-in-control	3,471	\$ 1.91	4.1	\$ 1,781

At December 31, 2008, there were 446,000 shares of common stock available for grant under the 2007 Plan.

For the nine months ended December 31, 2008 and 2007, the Company received \$911,000 and \$1.2 million, respectively, in cash from the exercise of stock options. Total stock-based compensation expense was \$92,000 and \$280,000 for the three and nine months ended December 31, 2008, respectively, and \$82,000 and \$207,000 for the three and nine months ended December 31, 2007, respectively. No income tax benefit was realized from activity in the Plans during the nine months ended December 31, 2008 and 2007.

At December 31, 2008, there was \$960,000 of total unrecognized compensation expense related to unvested stock options. This expense is expected to be recognized over a weighted-average period of approximately 3.1 years.

A summary of the grant date fair value and intrinsic value information is as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
	(In thousands, except per share amounts)			
Weighted average grant date fair value per share	\$ 16	\$ 1.82	\$ 1.50	\$ 1.81
Intrinsic value of options exercised	\$ 16	\$ 650	\$ 770	\$ 2,297

**6. Business Segment Information**



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The Company currently operates in three reportable segments: Roadway Sensors, Vehicle Sensors and Transportation Systems. The Roadway Sensors segment includes the Company's Vantage and VersiCam vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications. The Vehicle Sensors segment includes AutoVue and is comprised of all 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 except that certain expenses, such as interest, amortization of certain intangibles, and certain corporate expenses 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.

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The following table sets forth selected unaudited financial information for the Company's reportable segments for the three and nine months ended December 31, 2008 and 2007:

	Roadway Sensors	Vehicle Sensors	Transportation Systems	Total
	(In thousands)			
<b>Three Months Ended December 31, 2008</b>				
Product revenue	\$ 6,291	\$ 2,477	\$	\$ 8,768
Service and other revenue		315	7,379	7,694
Stock-based compensation	8	12	13	33
Depreciation and amortization	48	32	65	145
Segment income	773	105	425	1,303
<b>Three Months Ended December 31, 2007</b>				
Product revenue	\$ 6,432	\$ 2,281	\$	\$ 8,713
Service and other revenue		463	6,187	6,650
Stock-based compensation	3	10	6	19
Depreciation and amortization	26	32	39	97
Segment income	929	167	449	1,545
<b>Nine Months Ended December 31, 2008</b>				
Product revenue	\$ 21,334	\$ 8,380	\$	\$ 29,714
Service and other revenue		973	22,283	23,256
Stock-based compensation	24	36	39	99
Depreciation and amortization	144	105	185	434
Segment income	2,887	552	1,569	5,008
<b>Nine Months Ended December 31, 2007</b>				
Product revenue	\$ 21,273	\$ 7,630	\$	\$ 28,903
Service and other revenue		1,312	17,881	19,193
Stock-based compensation	13	34	19	66
Depreciation and amortization	79	98	105	282
Segment income	3,725	439	1,426	5,590

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
	(In thousands)			
Total income for reportable segments	\$ 1,303	\$ 1,545	\$ 5,008	\$ 5,590
Unallocated amounts:				
Corporate expenses	(69)	(415)	(360)	(586)
Other income, net	63	(3)	90	41
Interest expense, net	(141)	(314)	(537)	(1,046)
Income before income taxes	\$ 1,156	\$ 813	\$ 4,201	\$ 3,999

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



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*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 undertake 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. 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.*

### 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 and driver safety solutions to customers worldwide.the environmental

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 AutoVue Lane Departure Warning (LDW) system and is comprised of all 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 Vantage 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. Vantage video detection systems detect vehicle presence, count, speed, occupancy, 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, which was introduced in April of 2008, 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.

Our Vehicle Sensors segment addresses the leading cause of roadway fatalities: rear-end, lane change, and roadway departure accidents. According to the National Highway Traffic Safety Administration, these three crash types result in about 27,500 of the U.S.'s 42,000 annual traffic fatalities and contribute to a considerable economic loss due to injuries, property damage, and decreased productivity.

We developed the world's first production LDW system and offer a proven system that is available as an OEM option in passenger cars and as an OEM and aftermarket option on heavy trucks worldwide. The AutoVue LDW system utilizes 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 67,000 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

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systems are sold primarily to truck fleets, and to date, 71 U.S. heavy truck fleets have selected our LDW systems, with a combined fleet size estimated at 56,000 vehicles. Additionally, we have licensed our LDW technology to our strategic partner, Valeo Schalter and Sensuren GmbH, an independent automotive supplier ( Valeo ), resulting in sales to date of approximately 69,000 LDW systems for passenger cars.

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In addition to our LDW systems, we have expanded our Vehicle Sensors portfolio in August 2008 with newly developed technologies such as radar based Forward Collision Warning ( FCW ) and Blind Spot Warning ( BSW ) systems for the North American truck market. We also introduced Safety Direct in March 2008, which is a system that reports real-time 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 new products, together with the AutoVue LDW system, combine to create a broad 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, computers, 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 management systems business is largely dependent upon governmental funding and budgetary issues. The Federal Highway Bill that was passed in August 2005 provided for a significant increase in transportation funding. We believe the recent expansion of our transportation management systems business was due in part to the passage of the Federal Highway Bill, combined with increased transportation funds available at state and local agencies throughout the country. The 2005 Federal Highway Bill is set to expire in September 2009. At this point in time, the impact on future contract revenues as a result of the recently introduced federal stimulus package and any potential delays in the passage of future transportation bills cannot be determined.

**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 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, 2008. There have been no significant changes in our critical accounting policies and estimates during the nine months ended December 31, 2008 as compared to what was previously disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2008.

**Recent Accounting Pronouncements**

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In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 157, *Fair Value Measurements*, or SFAS 157, which defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value measurements. SFAS 157 does not require any new fair value measurements; rather it specifies valuation methods to be applied when fair value measurements are required under existing or future accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim



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periods within those fiscal years. In February 2008, the FASB issued FSP 157-2, *Effective Date of FASB Statement No. 157*, or FSP 157-2, which delays the effective date of SFAS 157 for non-financial assets and liabilities to fiscal years beginning after November 15, 2008. Generally, SFAS 157 will be applied prospectively. With respect to financial assets and liabilities, we adopted SFAS 157 in the first quarter of fiscal 2009. There was no material impact on our consolidated financial statements. We are currently evaluating the impact of SFAS 157 and FSP 157-2 with respect to our non-financial assets and liabilities and expect to adopt SFAS 157 and FSP 157-2 with respect to these assets and liabilities in the first quarter of our fiscal year ending March 31, 2010.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No 115*. This statement allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement of certain financial assets and liabilities on a contract-by-contract basis. Subsequent changes in fair value of these financial assets and liabilities would be recognized in earnings when they occur. This statement is effective for fiscal years beginning after November 15, 2007 with earlier adoption permitted under special rules. The adoption of this statement did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, or SFAS 141R. SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. The nature and magnitude of the specific effects of adopting SFAS 141R will depend upon the nature, terms and size of any acquisitions we may consummate after the effective date of the Company's adoption on April 1, 2009.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, or SFAS 162. SFAS 162 identifies the sources of accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP. SFAS 162 is effective 60 days following the Securities and Exchange Commission approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. We currently adhere to the hierarchy of U.S. GAAP as presented in SFAS 162, and adoption is not expected to have a material impact on our consolidated financial statements.

In June 2008, the FASB issued Emerging Issues Task Force Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock*, or EITF 07-5. EITF 07-5 clarifies how to determine whether certain instruments or features were indexed to an entity's own stock under EITF Issue No. 01-6, *The Meaning of Indexed to a Company's Own Stock*, and provides guidance to determine what accounting literature may apply to a particular equity linked instrument or feature. EITF 07-5 will become effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and must be applied to all instruments outstanding on the date of adoption. We are currently evaluating the impact of EITF 07-5, and have not yet determined the effect, if any, of its adoption on our consolidated financial statements.

Table of Contents**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 December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
Net sales and contract revenues:				
Net sales	55.2%	59.7%	57.9%	62.8%
Contract revenues	44.8	40.3	42.1	37.2
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	30.2	30.3	31.8
Cost of contract revenues	30.8	27.5	27.9	24.8
Gross profit	39.5	42.3	41.8	43.4
Operating expenses:				
Selling, general and administrative	26.7	28.3	26.8	27.3
Research and development	5.1	6.5	6.0	5.5
Amortization of intangible assets	0.2	0.2	0.2	0.2
Total operating expenses	32.0	35.0	33.0	33.0
Operating income	7.5	7.3	8.8	10.4
Non-operating income (expense):				
Other income, net	0.4	(0.0)	0.2	0.1
Interest expense, net	(0.9)	(2.0)	(1.0)	(2.2)
Income before income taxes	7.0	5.3	8.0	8.3
Income tax benefit (provision)	(2.5)	0.9	(3.3)	0.5
Net income	4.5%	6.2%	4.7%	8.8%

**Analysis of Quarterly Results of Operations**

*Net Sales and Contract Revenues.* Net sales are comprised of Roadway Sensors sales, which are derived from sales of our Vantage and VersiCam video detection systems, and Vehicle Sensor sales, which are derived from sales of our active vehicle safety products, contract engineering revenue from Valeo, and royalty revenue generated from sales of LDW systems, by our partner Valeo, to the passenger car market. Contract revenues consist entirely of Transportation Systems revenues, which are generated from systems integration and ITS consulting services with federal, state, county, and municipal agencies. We currently have a relatively diverse customer base with no customer representing greater than 10% of total net sales and contract revenues in the three and nine months ended December 31, 2008, respectively.

Total net sales and contract revenues increased 7.2% to \$16.5 million and 10.1% to \$53.0 million for the three and nine months ended December 31, 2008, respectively, compared to \$15.4 million and \$48.1 million in the corresponding periods of the prior fiscal year. The increase was primarily driven by higher contract revenues partially offset by a decrease in net Roadway Sensor revenues, as discussed below.

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Net sales decreased 1.0% to \$9.1 million and increased 1.6% to \$30.7 million for the three and nine months ended December 31, 2008, respectively, compared to \$9.2 million and \$30.2 million in the corresponding periods of the prior fiscal year.

Roadway Sensors net sales decreased 2.2% to \$6.3 million compared to \$6.4 million for the three months ended December 31, 2008 and were relatively flat for the nine months ended December 31, 2008 compared to the corresponding periods of the prior fiscal year mainly due to reduced and delayed spending on infrastructure projects as a result of the decline in commercial and residential construction, as well as local government budgetary pressures. We expect these factors may continue to adversely impact our Roadway Sensors net sales for at least the next few fiscal quarters.

Vehicle Sensors net sales increased 1.7% to \$2.8 million and 4.6% to \$9.4 million for the three and nine months ended December 31, 2008, respectively, versus \$2.7 million and \$8.9 million in the corresponding periods of the prior fiscal year. This increase was primarily a result of a slight increase in unit sales in the North American truck market, which was offset in part by lower unit sales of our LDW systems to European and Asian OEMs. Sales of

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LDW systems to the heavy truck market increased 8.6% to \$2.5 million and 9.8% to \$8.4 million for the three and nine month periods ended December 31, 2008, when compared to the corresponding periods in the prior fiscal year. We may continue to experience either relatively flat or decreased sales to the North American heavy truck market and in sales to our European and Asian OEMs customers in our next few fiscal quarters as a result of an overall decline in new truck sales in the U.S, Europe and Asia, the general slowdown in the U.S. credit markets and weakness in overall global economy. 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 \$315,000 and \$973,000 for the three and nine months ended December 31, 2008, respectively, compared to \$463,000 and \$1.3 million in the corresponding periods of the prior fiscal year. We expect contract engineering revenues to remain relatively stable for the foreseeable future.

Contract revenues increased 19.3% to \$7.4 million and 24.6% to \$22.3 million for the three and nine months ended December 31, 2008, respectively, compared to \$6.2 million and \$17.9 million in the corresponding periods of the prior fiscal year. This increase was largely a result of increased sales and marketing activity across the country. In response to this growth, we have slightly increased our Transportation Systems staff in the nine months ended December 31, 2008. We believe the ability of our Transportation Systems business to grow and successfully win and service new contracts will be highly dependent upon our continued success in recruiting and retaining qualified personnel. We anticipate that our contract revenues will continue to increase for the balance of fiscal 2009, largely as a result of significant new contracts awarded to us during the first six months of fiscal 2009. All of our contract revenues are derived from work performed in North America under a broad range of fixed price and cost plus fixed fee contracts.

It is conceivable that, as a result of the continued deterioration of economic conditions in the U.S., the decline in residential and commercial construction, the tightening of the credit markets, and the expiration of the 2005 Federal Highway Bill in September of 2009, government funding for certain traffic initiatives and roadway improvement projects could be delayed or diverted to focus on other budgetary needs. Should this occur, it is likely that future domestic Roadway Sensors net sales and Transportation System contract revenues and backlog would be adversely affected.

*Gross Profit.* Total gross profit was flat for the three months ended December 31, 2008 and increased 6.1% to \$22.1 million for the nine months ended December 31, 2008, respectively, as compared to \$6.5 million and \$20.9 million in the corresponding periods of the prior fiscal year. Total gross profit as a percent of net sales and contract revenues decreased to 39.5% and 41.8% for the three and nine months ended December 31, 2008, respectively, as compared to 42.3% and 43.4% in the corresponding periods of the prior fiscal year.

Gross profit as a percent of net sales was 46.2% and 47.7% for the three and nine months ended December 31, 2008, respectively, compared to 49.5% and 49.4% in the corresponding periods of the prior fiscal year. This decrease in gross profit as a percent of net sales was a result of decreased gross profit in both Roadway Sensors and Vehicle Sensors and was primarily driven by customer mix. Roadway Sensors net sales have been weighted more toward dealer than direct sales in fiscal 2009 while Vehicle Sensors net sales have been weighted more toward OEMs than after-market sales in fiscal 2009. We generally enjoy higher gross margins on direct and OEM sales when compared to dealer and aftermarket sales. We anticipate that this mix will remain relatively constant for the remainder of fiscal 2009. Gross profit as a percent of net sales generally fluctuates in any specific quarter based on customer mix. Gross profit as a percent of net sales has fluctuated over the last eleven quarters from a high of 50.0% in the first quarter of fiscal 2009 to a low of 43.2% reported in the second quarter of fiscal 2007.

Gross profit as a percent of contract revenues was 31.3% and 33.6% for the three and nine months ended December 31, 2008, respectively, compared to 31.6% and 33.2% in the corresponding periods of the prior fiscal year. 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 slight change in gross profit as a percent of contract revenues for the three and nine months ended December 31, 2008 reflects

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a contract mix weighted more toward contract revenues, which generally carry lower margins than our net sales, particularly if they require sub-contractor participation.

*Selling, General and Administrative Expense.* Selling, general and administrative expense increased 1.2% to \$4.4 million (or 26.6% of total net sales and contract revenues) and increased 7.5% to \$14.2 million (or 26.8% of total net sales and contract revenues) in the three and nine months ended December 31, 2008, respectively, compared to \$4.3 million (or 28.2% of total net sales and contract revenues) and \$13.2 million (or 27.4% of total net sales and contract revenues) in the corresponding periods of the prior fiscal year. These increases for the nine month period were largely attributable to higher selling expenses in our Transportation Systems segment, as a result of a shift in labor resources from project related activities to sales and marketing efforts, aimed at capturing additional contract backlog, and as a result, Transportation Systems sales & marketing expense increased to \$2.1 million during the nine months ended December 31, 2008 compared to \$1.3 million for the same period in the prior year.

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*Research and Development Expense.* Research and development expense decreased 15.4% to \$848,000 (or 5.2% of total net sales and contract revenues) and increased 21.2% to \$3.2 million (or 6.0% of total net sales and contract revenues) in the three and nine months ended December 31, 2008, respectively, compared to \$1.0 million (or 6.5% of total net sales and contract revenues) and \$2.6 million (or 5.5% of total net sales and contract revenues) in the corresponding periods of the prior fiscal year. Research and development expense decreased in the third quarter mainly because many of the Company's expenditures to bring new products to market were incurred in its first two fiscal quarters. The increase for the nine month period was primarily due to increased research and development activities in Roadway Sensors aimed at accelerating the time to market of certain new products. We believe research and development activities are crucial to our ability to continue to be a leader in our markets, and we expect our expenditures in this area to continue to run at an increased level, compared to the prior year, for the remainder of fiscal 2009.

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

*Interest Expense, Net.* Interest expense, net includes the following:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
	(in thousands)			
Interest expense	\$ (106)	\$ (228)	\$ (366)	\$ (787)
Amortization of debt discount	(21)	(51)	(103)	(155)
Amortization of deferred finance costs	(14)	(35)	(68)	(104)
Interest expense, net	\$ (141)	\$ (314)	\$ (537)	\$ (1,046)

Interest expense decreased for the three and nine months ended December 31, 2008 compared to the corresponding period in the prior fiscal year as a result of an overall lower level of borrowings in the current periods and as a result of the early retirement of certain of the Company's convertible debentures.

*Income Taxes.* During the three and nine months ended December 31, 2008, we recognized income tax expense of \$415,000 and \$1.7 million, respectively, as compared to income tax benefits of \$141,000 and \$221,000 in the three and nine months ended December 31, 2007, respectively. The increase in income tax expense and our effective tax rate in the current year periods was primarily due to the reduction of the valuation allowance recorded against our deferred tax assets in the prior year periods as a result of changes in our estimates of the future realizability of these assets. We analyze our tax estimates quarterly, and should those estimates result in an increase in future taxable income, we may continue to reduce our deferred tax asset valuation allowance, which totaled approximately \$8.0 million at December 31, 2008. This could cause our future overall effective tax rate in any given period to fluctuate from prior effective tax rates, estimated annual effective tax rates and statutory tax rates.

**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 debt and equity securities. We currently rely on cash flows from operations and borrowings on a line of credit facility to fund our operations. At December 31, 2008, we had \$15.8 million in working capital, no borrowings on our \$12.0 million working capital line of credit and \$6.0 million in cash and cash equivalents. This compares to working capital of \$14.9 million at March 31, 2008, which included no borrowings on our line of credit and \$421,000 in cash and cash equivalents.

Our operating activities provided \$6.0 million in cash during the nine months ended December 31, 2008, primarily as a result of net income generated during the period and the usage of deferred tax assets. We expect to continue to utilize our deferred tax assets to significantly reduce cash tax payments in future quarters. Accounts receivable decreased during the nine months ended December 31, 2008 by \$258,000 primarily due to decreased sales and the timing of invoicing and collections for all segments. Net unbilled accounts receivable also decreased by \$2.0 million during the nine months ended December 31, 2008 as a result of the timing of invoicing in Transportation Systems. Inventories increased by \$771,000 as a result of flat product sales, the introduction of new products by Roadway Sensors and the acquisition of certain components because they have been discontinued by the manufacturer. We expect inventories to slightly increase for the remainder of fiscal 2009.

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Our investing activities for the nine months ended December 31, 2008 and 2007 consisted entirely of purchases of property and equipment, which aggregated \$716,000 and \$455,000, respectively.

Cash provided by financing activities was \$240,000 in the nine months ended December 31, 2008, which was primarily the result of \$911,000 in proceeds from the exercise of outstanding stock options to purchase our common stock and borrowings of \$5.1 million pursuant to the Company's term note, offset by \$5.8 million used to redeem convertible debentures. During the nine months ended December 31, 2007, financing activities used \$4.3 million of cash, which was the result of \$5.6 million in net payments against borrowings, partially offset by \$1.3 million in proceeds from the exercise of outstanding stock options and warrants to purchase our common stock.

*Borrowings*

The following table summarizes our borrowings and long-term debt:

	<b>At December 31, 2008</b>	
	<b>(In thousands)</b>	
Convertible debentures, net	\$	2,232
Bank term note		5,073
	\$	7,305

Until October 15, 2008, we had a credit facility with Silicon Valley Bank that provided for line of credit borrowings of up to \$10.0 million. Under this credit facility, we could borrow against eligible accounts receivable and eligible inventory, as defined in the credit agreement. Interest on borrowed amounts under the line of credit was payable monthly at the current stated prime rate plus 1.00%. Additionally, we were obligated to pay an unused line fee of 0.25% per annum applied to the amount by which the maximum credit amount exceeded the average daily principal balance during the preceding month. The credit facility required \$2,000 in monthly collateral management fees and included an early termination fee equal to 2% of the total facility during the first year of the agreement and 1% of the total facility in the second year of the agreement. The credit facility was secured by substantially all of our assets. This credit facility expired on October 15, 2008.

Effective October 16, 2008, we entered into a new \$19.5 million credit facility with California Bank & Trust, which replaced our \$10.0 million facility with Silicon Valley Bank. This new credit facility provides for a \$12.0 million, two-year, revolving line of credit and a term note of up to \$7.5 million as discussed below. Interest on borrowed amounts under the revolving line will be 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. We are obligated to pay an unused line fee of 0.25% per annum applied to the average unused portion of the \$12.0 million revolving line of credit during the preceding month. No amounts were borrowed under the \$12.0 million revolving line of credit as of December 31, 2008.

Additionally, as part of this new credit facility and in connection with the early retirement of \$7.0 million of our convertible debentures, we have borrowed \$6.5 million (\$5.07 million in October 2008 and \$1.47 million in January 2009) and may borrow up to another \$1.0 million in the form of a \$7.5 million 48-month term note to retire all outstanding debentures. Principal payments under this term note are required to be repaid in 48 monthly installments commencing on June 1, 2009. Interest on the term note will be 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



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to the total loan commitment under the credit facility. In October 2008, we paid an upfront loan commitment fee of \$28,000 in connection with the term note portion of the credit facility. The new credit facility contains no early termination fees and is secured by substantially all of our assets.

On February 4, 2009 we entered into an Amended and Restated Loan and Security Agreement with California Bank & Trust which supersedes the agreements entered into on October 16, 2008 in their entirety. The October 16, 2008 documents were amended and restated to clarify the meaning of certain ambiguities and remove non-applicable language. No modifications were made to any significant provisions related to the overall amount of the credit facility, interest rate calculations, or any financial or non-financial covenant.

We believe that the cash generated from our operations, together with funds available under our credit facility, will be sufficient to fund our operations for at least the next twelve months. However, should a shortfall occur, we may need to raise additional funds through other debt or equity financings.

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Our contractual obligations at December 31, 2008, updated to reflect the early retirement and refinancing of convertible debentures in January 2009, were as follows:

	Payments Due by Fiscal Year							Total
	2009	2010	2011	2012 (In thousands)	2013	Thereafter		
Term note payable	\$	\$ 1,870	\$ 2,144	\$ 2,144	\$ 415	\$	\$ 6,573	
Convertible debentures		750					750	
Operating leases	812	1,661	1,444	1,365	1,380	2,460	9,122	
Total	\$ 812	\$ 4,281	\$ 3,588	\$ 3,509	\$ 1,795	\$ 2,460	\$ 16,445	

At December 31, 2008, we had firm commitments to purchase inventory in the amount of \$2.5 million during our next three fiscal quarters.

**Off Balance Sheet Arrangements**

In May 2004, we issued subordinated convertible debentures in an aggregate original principal amount of \$10.1 million. These debentures are due in full on May 18, 2009 and are convertible into shares of our common stock at an initial conversion price of \$3.61 per share. To date, all but \$750,000 of these debentures have been retired. Because these debentures are conventionally convertible, we have not separately accounted for the conversion feature and, accordingly, no separate amounts are presented in our condensed consolidated financial statements in connection with this conversion feature.

At December 31, 2008, outstanding warrants to purchase an aggregate of 246,250 shares of our common stock at an exercise price of \$3.25 per share were callable by us if the closing sales price of our common stock for 20 consecutive days is equal to or greater than two times the exercise price of the warrants. Outstanding warrants to purchase an aggregate of 75,000 shares of our common stock at an exercise price of \$5.00 per share were callable by us if the price of our common stock for 20 consecutive days is equal to or greater than one and a half times the exercise price of the warrants.

In connection with warrants to purchase 246,250 shares of our common stock at an exercise price of \$3.25 per share, 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 underlying shares of common stock. These warrants have been accounted for within equity in our condensed consolidated balance sheets in accordance with Emerging Issues Task Force Issue 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, and, accordingly, no liabilities have been recorded in connection therewith. 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 December 31, 2008) 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 3.58%) 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.

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**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.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information set forth under the heading "Litigation and Other Contingencies" in Note 4 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item I 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 IS LEADING TO REDUCED OR DELAYED GOVERNMENT FUNDING FOR TRANSPORTATION INFRASTRUCTURE PROJECTS, AND INITIATIVES AND DECREASED AVAILABILITY OF FINANCIAL CAPITAL FOR OUR CUSTOMERS, WHICH COULD HAVE AN ADVERSE IMPACT ON OUR NET SALES AND CONTRACT REVENUES.** Decreased consumer confidence, 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 have had a negative impact on customer orders and government funding of infrastructure projects incorporating our products and services. Such concerns may result in cancellations and rescheduling of backlog. In addition, the recent decline in the U.S. real estate market, particularly in new home and commercial construction, has adversely impacted new road construction and has resulted in and may continue to result in flat or slightly declining Roadway Sensor and Vehicle Sensor net sales and could 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. If such conditions continue or worsen, our business, financial condition and results of operations could be materially and adversely affected.

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**CURRENT BUDGETARY CONSTRAINTS AND THE SIGNIFICANT MILITARY OPERATIONS IN THE MIDDLE EAST OR ELSEWHERE MAY IMPACT GOVERNMENT FUNDING OR CONSUMER SPENDING, CAUSING A DECLINE IN OUR REVENUES.** In the near term, the funding of U.S. military operations in the Middle East or elsewhere may cause disruptions in funding of government contracts. Since military operations of such magnitude are not routinely included in U.S. defense budgets, supplemental legislative funding actions are often required to finance such operations. Even when such legislation is enacted, it may not be adequate for ongoing operations, causing other government resources to be temporarily or permanently diverted. Since a significant portion of our sales are derived from contracts with government agencies, such diversion of funds could produce interruptions in funding or delays in receipt of our contracts, causing disruptions and adversely affecting our revenue and operations.

**WE DEPEND ON GOVERNMENT CONTRACTS AND SUBCONTRACTS, AND BECAUSE MANY OF OUR GOVERNMENT CONTRACTS ARE FIXED PRICE CONTRACTS, HIGHER THAN ANTICIPATED COSTS WILL REDUCE OUR PROFIT AND COULD ADVERSELY IMPACT OUR OPERATING RESULTS.** 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 38.1%, 37.8% and 38.3% of our total net sales and contract revenues for the years ended March 31, 2008, 2007 and 2006, 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:

- long purchase cycles or approval processes;
- competitive bidding and qualification requirements;
- the impact of international conflicts;
- 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 in September of 2009;
- 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.

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.

**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 of our components in our AutoVue and Vantage products. Should any such delay or disruption occur, our future sales will likely be materially and adversely affected. Additionally, we rely heavily on select contract manufacturers to produce many of our 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 if necessary, we could experience a production gap if for any reason our contract manufacturers were unable to meet our production requirements.

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**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.

**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 expect such competition to increase due to technological advancements, industry consolidations and reduced barriers to entry. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any of which could seriously harm our business, financial condition and results of operations. In fiscal 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. In addition, one of the other developers of LDW systems was acquired by a large multinational organization during fiscal 2009. This new competitor 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. Additional new competitors may enter this market in the future. Furthermore, awareness of LDW technology is increasing and other market players are attempting to develop 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 erode our ability to successfully market and sell our LDW systems to new and existing customers.

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.

**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 product 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 AutoVue in the passenger car market. The success of our AutoVue 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.

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Certain of the components used in our Vantage and AutoVue 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 Vantage and AutoVue 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 historically 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 AUTOVUE TECHNOLOGIES FOR THE OEM PASSENGER CAR MARKET.** We have granted Valeo the exclusive right to sell and manufacture our AutoVue LDW system to the worldwide passenger car market in exchange for royalty payments for each AutoVue unit sold. As such, the future success and broad market acceptance of our AutoVue 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 could be adversely affected.

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**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 system is 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 AutoVue and Vantage products internationally and we anticipate that our international operations will 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.

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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.

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.

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**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. Section 404 also requires our independent registered public accounting firm to attest to, and report on, management's assessment of our internal controls over financial reporting beginning with our fiscal year ending March 31, 2010. 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 auditors 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 error or mistake. 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.

As of March 31, 2005, we became aware of a material weakness in our internal controls related to the accounting for the consolidation of our deferred compensation savings plan and certain contract administration. Based on our evaluation, our management concluded that, as of March 31, 2004, our internal control over financial reporting was not effective due to the existence of one material weakness. The weakness was immediately corrected. We cannot assure you that we or our independent registered public accounting firm will not identify additional material weaknesses in our internal controls. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. If our internal controls over financial reporting are not considered adequate, we may experience a loss of public confidence, which could have an adverse effect on our business and our stock price.

**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 ranging from positive cash flows from operations of \$7.6 million in the fiscal year ended March 31, 2008 to negative cash flows from operations of \$2.0 million in the fiscal year ended March 31, 2007. Although we entered into a new \$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 refinance the remaining debentures, pursue acquisitions or to expand our operations.

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At December 31, 2008, we had \$6.0 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;

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- 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;
- 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:

- 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;
- delays in government contracts and funding from time to time and budgetary constraints at the federal, state and local levels;
- declines in new home construction and related road and other infrastructure construction;
- 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;



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- 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;

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- 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;
- 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 PERIODS. 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 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

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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.

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**WE HAVE HISTORICALLY EXPERIENCED SUBSTANTIAL LOSSES AND MAY EXPERIENCE LOSSES IN THE FUTURE.**

Although we have achieved net income in our past three 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 continue to experience operating losses and net losses, 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 2000, 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 \$29.44 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;
- 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, with the exception of our Iteris business, 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), paid this supplier \$125,000 on October 20, 2006 and are required to pay an additional \$350,000 in 36 equal monthly installments of \$9,700 through October 2009. 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.

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**SOME OF OUR DIRECTORS, OFFICERS AND THEIR AFFILIATES CAN CONTROL THE OUTCOME OF MATTERS THAT REQUIRE THE APPROVAL OF OUR STOCKHOLDERS, AND ACCORDINGLY WE WILL NOT BE ABLE TO ENGAGE IN CERTAIN TRANSACTIONS WITHOUT THEIR APPROVAL.** As of December 31, 2008, our officers and directors beneficially owned approximately 11% of the outstanding shares of our common stock (and approximately 15% of our common stock when including options, warrants and other convertible securities held by them which are currently exercisable or convertible or will become exercisable or convertible within 60 days after December 31, 2008). As a result of their stock ownership, our management will be able to influence the election of our directors and the outcome of corporate actions requiring stockholder approval, such as mergers and acquisitions, regardless of how our other stockholders may vote. This concentration of voting control may have a significant effect in delaying, deferring or preventing a change in our management or change in control and may adversely affect the voting or other rights of other holders of common stock.

**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. Our future issuance of preferred stock also could be used to effect a shareholder rights plan which could discourage an unsolicited acquisition proposal.

**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**

None.

**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 not to be sold at a price below \$2.75. The options shares are set to expire on September 26, 2011.

On February 4, 2009 the Company entered into an Amended and Restated Loan and Security Agreement with California Bank & Trust which supersedes the agreements entered into on October 16, 2008 in their entirety. The Amended and Restated Loan and Security Agreement is included as an exhibit with the filing (Exhibit 10.1). The October 16, 2008 documents were amended and restated to clarify the meaning of certain ambiguities and remove non-applicable language. No modifications were made to any significant provisions related to the overall amount of the credit facility, interest rate calculations, or any financial or non-financial covenant.

Table of Contents**ITEM 6. EXHIBITS**

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

<b>Exhibit Number</b>	<b>Description</b>	<b>Where Located</b>
3.1	Amended and Restated Certificate of Incorporation of the registrant	<i>Exhibit 3.1 to the registrant's Current Report on Form 8-K as filed with the SEC on October 28, 2004</i>
3.2	Certificate of Amendment to Amended and Restated Certificate of Incorporation filed September 26, 2007	<i>Exhibit 3.2 to the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 as filed with the SEC on November 13, 2007</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>
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>
10.1	Amended and Restated Loan and Security Agreement on February 4, 2009 by and between California Bank & Trust and the registrant	<i>Filed herewith</i>
10.2	Debenture Redemption Agreement, dated October 17, 2008, by and between the registrant and certain affiliates of Bryant R. Riley	<i>Filed herewith</i>
10.3	Debenture Redemption Agreement, dated October 27, 2008, by and between the registrant and each of Lloyd I. Miller, III, Lloyd I. Miller Trust A-4, Milfam I, L.P. and Milfam II, L.P.	<i>Filed herewith</i>
10.4	Debenture Redemption Agreement, dated January 9, 2009, by and between the registrant and each of Irvin Kessler and Provident Premier Master Fund Ltd.	<i>Filed herewith</i>
31.1		<i>Filed herewith</i>



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Certification of the Principal Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of the Principal Financial and Accounting Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *Filed herewith*

32.1 Certification of the Chief Executive Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *Filed herewith*

32.2 Certification of the Chief Financial Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *Filed herewith*

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**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: February 12 , 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)