ITERIS, INC.
Form 10-Q
August 01, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended June 30, 2008
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 001-08762

ITERIS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**95-2588496** (I.R.S. Employer Identification No.)
1700 Carnegie Avenue, Suite 100 **Santa Ana, California** (Address of principal executive office)	**92705** (Zip Code)

(949) 270-9400

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, 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 x No o

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 o	**Accelerated filer o**
Non-accelerated filer o (Do not check if a smaller reporting company)	**Smaller reporting company x**

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

Yes o No x

As of July 30, 2008, the registrant had 33,971,002 shares of common stock outstanding.

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ITERIS, INC.

Quarterly Report on Form 10-Q
For the Three Months Ended June 30, 2008

Unless otherwise indicated in this report, the Company, we, us and our collectively refer to Iteris, Inc.

AutoVue®, Iteris®, Vantage® and eAccess 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)

	June 30, 2008 (unaudited)	March 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 68**	$ 421
Trade accounts receivable, net of allowance for doubtful accounts of $1,032 and $1,020 at June 30, 2008 and March 31, 2008, respectively	**16,027**	13,108
Costs and estimated earnings in excess of billings on uncompleted contracts	**4,144**	5,351
Inventories, net of reserve for inventory obsolescence of $885 and $819 at June 30, 2008 and March 31, 2008, respectively	**4,380**	4,226
Deferred income taxes	**2,541**	2,541
Prepaid expenses and other current assets	**451**	371
Total current assets	**27,611**	26,018
Property and equipment, net	**3,482**	3,467
Deferred income taxes	**7,807**	7,807
Intangible assets, net	**221**	257
Goodwill	**27,774**	27,774
Other assets	**296**	322
Total assets	**$ 67,191**	$ 65,645
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Trade accounts payable	**$ 3,552**	$ 3,902
Accrued payroll and related expenses	**3,507**	3,825
Accrued liabilities	**2,901**	1,973
Billings in excess of costs and estimated earnings on uncompleted contracts	**1,306**	1,126
Revolving line of credit		
Current portion of long-term debt	**7,630**	244
Total current liabilities	**18,896**	11,070
Deferred rent	**1,899**	1,956
Unrecognized tax benefits	**1,380**	1,381
Other non-current liabilities	**105**	461
Long-term debt		7,566
Total liabilities	**22,280**	22,434
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $1.00 par value, 2,000 shares authorized, none issued and outstanding at June 30, 2008 and March 31, 2008		
Common stock, $0.10 par value, 70,000 shares authorized, 33,891 and 33,420 shares issued and outstanding at June 30, 2008 and March 31, 2008, respectively	**3,389**	3,342
Additional paid-in capital	**136,333**	135,516
Common stock held in trust, 24 and 167 shares at June 30, 2008 and March 31, 2008, respectively	**(31)**	(202)
Accumulated deficit	**(94,833)**	(95,499)
Accumulated other comprehensive income	**53**	54
Total stockholders equity	**44,911**	43,211
Total liabilities and stockholders equity	**$ 67,191**	$ 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)

	Three Months Ended June 30, 2008	2007
Net sales and contract revenues:		
Net sales	**$ 10,526**	$ 10,244
Contract revenues	**6,916**	5,513
Total net sales and contract revenues	**17,442**	15,757
Costs of net sales and contract revenues:		
Cost of net sales(a)	**5,267**	5,175
Cost of contract revenues(a)	**4,423**	3,488
Gross profit	**7,752**	7,094
Operating expenses:		
Selling, general and administrative(a)	**5,156**	4,489
Research and development(a)	**1,210**	994
Amortization of intangible assets	**36**	37
Total operating expenses	**6,402**	5,520
Operating income	**1,350**	1,574
Non-operating income (expense):		
Other income, net	**5**	19
Interest expense, net	**(198)**	(363)
Income before income taxes	**1,157**	1,230
Income tax provision	**(491)**	(134)
Net income	**$ 666**	$ 1,096
Earnings per share:		
Basic	**$ 0.02**	$ 0.03
Diluted	**$ 0.02**	$ 0.03
Weighted average shares outstanding:		
Basic	**33,618**	32,089
Diluted	**34,939**	34,317

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

Cost of net sales	**$ 2**	$ 1
Cost of contract revenues	**10**	3
Selling, general and administrative expense	**77**	59
Research and development expense	**5**	3
Total	**$ 94**	$ 66

See accompanying notes to unaudited condensed consolidated financial statements.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended June 30, 2008	2007
Cash flows from operating activities		
Net income	**$ 666**	$ 1,096
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	**242**	149
Stock-based compensation expense	**94**	66
Amortization of debt discount	**41**	52
Amortization of intangible assets	**36**	37
Amortization of deferred financing costs	**27**	35
Change in deferred tax assets		104
Amortization of deferred gain on sale leaseback transaction		(71)
Changes in operating assets and liabilities:		
Accounts receivable	**(2,919)**	1,822
Net costs and estimated earnings in excess of billings	**1,387**	(1,682)
Inventories	**(154)**	458
Prepaid expenses and other assets	**(81)**	(511)
Accounts payable and accrued liabilities	**(5)**	308
Net cash provided by (used in) operating activities	**(666)**	1,863
Cash flows from investing activities		
Purchases of property and equipment	**(257)**	(137)
Cash flows from financing activities		
Proceeds from stock option exercises	**514**	726
Change in checks drawn in excess of available bank balances	**277**	(47)
Payments on long-term debt	**(221)**	(648)
Net borrowings on line of credit		422
Net cash provided by financing activities	**570**	453
Increase (decrease) in cash	**(353)**	2,179
Cash at beginning of period	**421**	35
Cash at end of period	**$ 68**	$ 2,214
Supplemental cash flow information:		
Cash paid during the period:		
Interest	**$ 130**	$ 301
Income taxes	**187**	48
Supplemental schedule of non-cash investing and financing activities:		
Fair value of common stock issued in settlement of liabilities	**$ 427**	$ 350
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

June 30, 2008

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Iteris, Inc. is a leader in the traffic management market and focuses on the development and application of advanced technologies that reduce traffic congestion, minimize the environmental impact of traffic congestion and improve the safety of surface transportation systems. By combining outdoor image processing, traffic engineering and information technology, the Company offers a broad range of Intelligent Transportation Systems and driver safety solutions to customers worldwide. 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 June 30, 2008, the consolidated results of operations for the three months ended June 30, 2008 and 2007, and the consolidated cash flows for the three months ended June 30, 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 months ended June 30, 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

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

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

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.

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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.

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* (SFAS 123).

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 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 fiscal years. In February 2008, the FASB issued 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. In 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 FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115.* This standard 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 the consolidated financial statements of the Company.

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2. Supplemental Financial Information

Inventories

The following table presents details of the Company s inventories:

		June 30, 2008		March 31, 2008
		(In thousands)		
Materials and supplies	**$**	**3,656**	$	3,031
Work in process		**160**		345
Finished goods		**564**		850
	$	**4,380**	$	4,226

Intangible Assets

	June 30, 2008				March 31, 2008			
		Gross Carrying Amount		Accumulated Amortization		Gross Carrying Amount		Accumulated Amortization
				(In thousands)				
Developed technology	**$**	**495**	**$**	**(406)**	$	495	$	(381)
Patents		**317**		**(185)**		317		(174)
Total	**$**	**812**	**$**	**(591)**	$	812	$	(555)

Amortization expense for intangible assets subject to amortization was $36,000 and $37,000 for the three months ended June 30, 2008 and 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)**		
2009	$	111
2010		58
2011		46
2012		6
	$	221

Warranty Reserve Activity

The following table presents activity in accrued warranty obligations:

	Three Months Ended June 30,			
	2008		2007	
	(In thousands)			
Balance at beginning of period	$	**494**	$	520
Additions charged to cost of sales		**99**		99
Warranty claims		**(64)**		(50)
Balance at end of period	$	**529**	$	569

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Earnings Per Share

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

	Three Months Ended June 30, 2008		2007
	(In thousands, except per share amounts)		
Numerator:			
Net income	$	**666**	$ 1,096
Denominator:			
Weighted average common shares used in basic computation		**33,618**	32,089
Dilutive stock options		**1,314**	2,197
Dilutive warrants		**7**	31
Weighted average common shares used in dilutive computation		**34,939**	34,317
Earnings per share:			
Basic	**$**	**0.02**	$ 0.03
Diluted	**$**	**0.02**	$ 0.03

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

	Three Months Ended June 30, 2008	2007
	(In thousands)	
Stock options	**517**	668
Warrants	**1,150**	1,190
Convertible debentures	**2,147**	2,729

3. Revolving Line of Credit and Long-Term Debt

Revolving Line of Credit

In October 2006, the Company entered into a two-year credit facility with a bank. At June 30, 2008, the facility provided for line of credit borrowings of up to $10.0 million. Under the credit facility, the Company may borrow against its eligible accounts receivable and eligible inventory, as defined in the credit agreement. Interest on borrowed amounts under the line of credit is payable monthly at the current stated prime rate plus 1.00% (6.00% at June 30, 2008). Additionally, the Company is obligated to pay an unused line fee of 0.25% per annum applied to the amount by which the maximum credit amount exceeds the average daily principal balance during the preceding month. The credit facility requires $2,000 in monthly collateral management fees and includes 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 is secured by substantially all of the assets of the Company.

On June 30, 2008, the available credit under the Company s credit facility was $9.9 million, all of which was unused.

Long-Term Debt

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

		June 30, 2008		March 31, 2008
		(In thousands)		
Convertible debentures, net	**$**	**7,607**	$	7,566
Bank term note				210
Other		**23**		34
		7,630		7,810
Less current portion		**(7,630)**		(244)
	$		$	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 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.

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The debentures are due in full on May 19, 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 June 30, 2008, $250,000 of convertible debentures had been converted into 69,252 shares of common stock and $2.1 million of convertible debentures had been retired early leaving $7.8 million of the originally issued convertible debentures outstanding at June 30, 2008.

Bank Term Note. 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. In October 2006, the term note was assumed by the Company s new bank as part of the Company s new credit facility. The new term note was also due on May 27, 2008 and provided for monthly principal payments of approximately $104,000. Interest accrued under the new term note at an annual rate of 8.75%. The final payment against this term note was made in June 2008.

Scheduled aggregate maturities of long-term debt principal as of June 30, 2008 were as follows:

Fiscal Year Ending March 31, (In thousands)		
2009	**$**	**23**
2010		**7,750**
		7,773
Less: unamortized debt discount		**(143)**
	$	**7,630**

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.

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 June 30, 2008 were as follows:

Fiscal Year Ending March 31, (In thousands)		
Remainder of 2009	$	**1,398**
2010		**1,544**
2011		**1,412**
2012		**1,332**
2013		**1,363**
Thereafter		**2,460**
Total	$	**9,509**

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 three of the Company s directors, one of which is the Chief Executive Officer of MAXxess. At June 30, 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 intends to pursue full payment of any and all amounts due from MAXxess.

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Inventory Purchase Commitments

At June 30, 2008, the Company had firm commitments to purchase inventory in the amount of $1.6 million during the next three fiscal quarters.

5. Stock-Based Compensation

The Company s 2007 Omnibus Incentive Plan (the 2007 Plan) provides that options to purchase shares of the Company s unissued common stock may be granted to employees, officers, consultants and directors to the Company 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 based on the value of the Company s common stock. New shares are issued to satisfy stock option exercises and share issuances under the 2007 Plan. As of June 30, 2008, options to purchase an aggregate of 389,000 shares of common stock were outstanding under the 2007 Plan.

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 June 30, 2008, options to purchase 1.4 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 what was previously its 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 June 30, 2008, options to purchase 2.2 million shares of the Company s common stock were outstanding under the 1998 Plan. 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.

A summary of activity in the Plans for the three months ended June 30, 2008 is as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
	(In thousands, except per share amounts and number of years)			
Options outstanding at March 31, 2008	4,524	$ 1.83	3.7	
Granted		N/A	N/A	

Exercised	(471)		1.10	N/A		
Forfeited			N/A	N/A		
Expired	(30)		1.35	N/A		
Options outstanding at June 30, 2008	4,023	$	1.92	4.1	$	3,875
Vested and expected to vest at June 30, 2008	3,906	$	1.91	3.9	$	3,860
Options exercisable at June 30, 2008	3,400	$	1.82	3.2	$	3,798
Options exercisable at June 30, 2008 pursuant to a change-in-control	4,023	$	1.92	4.1	$	3,875

At June 30, 2008, there were 461,000 shares of common stock available for grant under the 2007 Plan.

For the three months ended June 30, 2008 and 2007, the Company received $514,000 and $726,000, respectively, in cash from the exercise of stock options. Total stock-based compensation expense was $94,000 and $66,000 for the three months ended June 30, 2008 and 2007, respectively. No income tax benefit was realized from activity in the Plans during the three months ended June 30, 2008 and 2007.

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At June 30, 2008, there was $1.2 million of total unrecognized compensation expense related to unvested stock options. This expense is expected to be recognized over a weighted-average period of approximately 3.4 years.

The fair value of each stock-based award 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. No stock options were granted in either of the three month periods ended June 30, 2008 on 2007.

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

	Three Months Ended June 30, 2008		2007	
	(In thousands, except per share amounts)			
Weighted average grant date fair value per share of options granted		**N/A**		N/A
Intrinsic value of options exercised	**$**	**656**	$	1,417

6. Business Segment Information

The Company currently operates in three reportable segments: Roadway Sensors, Vehicle Sensors and Transportation Systems. The Roadway Sensors segment includes the Company s Vantage 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 lane departure warning systems for 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.

The following table sets forth selected unaudited financial information for the Company s reportable segments for the three months ended June 30, 2008 and 2007:

		Roadway Sensors		Vehicle Sensors		Transportation Systems		Total
				(In thousands)				
Three Months Ended June 30, 2008								
Product revenue	$	7,426	$	2,726	$		$	10,152
Service and other revenue				374		6,916		7,290
Stock-based compensation expense		8		12		13		33

Depreciation and amortization		48		37		56		141
Segment income		1,008		158		406		1,572
Three Months Ended June 30, 2007								
Product revenue	$	7,224	$	2,584	$		$	9,808
Service and other revenue				436		5,513		5,949
Stock-based compensation expense		6		13		7		26
Depreciation and amortization		26		36		31		93
Segment income		1,105		50		544		1,699

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

	Three Months Ended June 30, 2008	2007
	(In thousands)	
Total income for reportable segments	**$ 1,572**	$ 1,699
Unallocated amounts:		
Corporate expenses	**(222)**	(125)
Other income, net	**5**	19
Interest expense, net	**(198)**	(363)
Income before income taxes	**$ 1,157**	$ 1,230

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

This report, including the following discussion and analysis, contains forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995) that are based on our current expectations, estimates and projections about our business and our industry, and reflect management s beliefs and certain assumptions made by us based upon information available to us as of the date of this report. When used in this report and the information incorporated herein by reference, the words expect(s), feel(s), believe(s), should, will, may, anticipate(s), estimate(s) and similar expressions or variations of these words are intended to identify forward-looking statements. These forward-looking statements include but are not limited to statements regarding our anticipated sales, revenue, expenses, profits, capital needs, competition, development plans, backlog and manufacturing capabilities, the applications for and acceptance of our products and services, and the status of our facilities and product development. These statements are not guarantees of future performance and are subject to certain risks and uncertainties that could cause our actual results to differ materially from those projected. You should not place undue reliance on these forward-looking statements that speak only as of the date hereof. We 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 that focuses on the development and application of advanced technologies that reduce traffic congestion, minimize the environmental impact of traffic congestion and improve the safety of surface transportation systems. By combining outdoor image processing, traffic engineering and information technology, we offer a broad range of Intelligent Transportation Systems (ITS) and driver safety solutions to customers worldwide.

We currently operate in three reportable segments: Roadway Sensors, Vehicle Sensors and Transportation Systems. The Roadway Sensors segment includes our Vantage vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications. The Vehicle Sensors segment is comprised of all activities related to our AutoVue Lane Departure Warning (LDW) systems for 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 is a video vehicle detection system that detects the presence of vehicles on roadways. Vantage systems are used at signalized intersections to enable a traffic controller to more efficiently allocate green signal time and are also used for incident detection and highway traffic data collection applications. We sell and distribute our Vantage products primarily to commercial customers and municipal agencies.

Our AutoVue LDW systems consist of a small windshield mounted sensor that uses proprietary software to detect and warn drivers of unintended lane departures. In excess of 90,000 production AutoVue units have been sold for car and truck platforms in the North American and European markets. Our AutoVue LDW systems are currently qualified as an option on certain heavy trucks, including Mercedes-Benz, MAN, Iveco, DAF, Scania, Freightliner and FUSO, as well as Neoplan and MAN luxury bus and coach lines. In North America, our LDW systems are sold primarily to truck fleets, and to date, 65 U.S. heavy truck fleets have selected our LDW systems, representing an estimated 49,000 vehicles.

Our transportation management systems business 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 over the following six years. 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 2009. It is too early to determine any impact on future contract revenues as a result of potential delays in the passage of future bills.

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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 U.S generally accepted accounting principles. 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 three months ended June 30, 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

In September 2006, the FASB issued 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 fiscal years. In February 2008, the FASB issued 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. In 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. 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 FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115*. This standard 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 the consolidated financial statements of the Company.

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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 June 30, 2008	2007
Net sales and contract revenues:		
Net sales	**60.3%**	65.0%
Contract revenues	**39.7**	35.0
Total net sales and contract revenues	**100.0%**	100.0%
Costs of net sales and contract revenues:		
Cost of net sales	**30.2**	32.9
Cost of contract revenues	**25.4**	22.1
Gross profit	**44.4**	45.0
Operating expenses:		
Selling, general and administrative	**29.6**	28.5
Research and development	**6.9**	6.3
Amortization of intangible assets	**0.2**	0.2
Total operating expenses	**36.7**	35.0
Operating income	**7.7**	10.0
Non-operating income (expense):		
Other income, net	**0.0**	0.1
Interest expense, net	**(1.1)**	(2.3)
Income before income taxes	**6.6**	7.8
Income tax provision	**(2.8)**	(0.8)
Net income	**3.8%**	7.0%

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 video detection systems, and Vehicle Sensor sales, which are derived from sales of AutoVue LDW systems, contract engineering revenue and royalty revenue generated from AutoVue related activities. 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 our largest customer constituting 6.2% of total net sales and contract revenues in the three months ended June 30, 2008.

Total net sales and contract revenues increased 10.7% to $17.4 million for the three months ended June 30, 2008, compared to $15.8 million in the corresponding period of the prior fiscal year. The increase was primarily driven by increased contract revenues, as discussed below.

Net sales increased 2.8% to $10.5 million for the three months ended June 30, 2008, compared to $10.2 million in the corresponding period of the prior fiscal year.

Roadway Sensors net sales increased 2.8% to $7.4 million for the three months ended June 30, 2008, versus $7.2 million in the corresponding period of the prior fiscal year. The increase in Roadway Sensors net sales for the three months ended June 30, 2008 reflects the continued adoption of video vehicle detection technology, such as the technology offered by our Vantage line of products, both domestically and internationally. We continue to believe that the current increased rate of adoption has to some extent been due to increased government spending on traffic initiatives, which we believe has been at least partially made possible by the passage of the Federal Highway Bill in August 2005, as well as expanded sales and marketing efforts, particularly in North America. The 2005 Federal Highway Bill is set to expire in 2009. It is too early to determine any impact on future Roadway Sensors revenues as a result of potential delays in the passage of future bills.

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Vehicle Sensors net sales increased 2.6% to $3.1 million for the three months ended June 30, 2008, versus $3.0 million in the corresponding period of the prior fiscal year. This increase was primarily a result of increased unit sales of our LDW systems to European and Asian OEMs, offset in part, by decreased unit sales in North America. Sales of LDW systems to the heavy truck market increased by $142,000, or 5.5%, for the three month period ended June 30, 2008, when compared to the corresponding period in the prior fiscal year. We expect sales of LDW units to the heavy truck market to continue to increase, when compared to the prior year period, for at least the remainder of calendar year 2008 due to increased sales of LDW units in Europe and Asia; however, we expect to experience either flat or decreased sales to the North American heavy truck market in our next few fiscal quarters as a result of an overall decline in new truck sales in the U.S., the general slowdown in the U.S. housing market and overall 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 Schalter and Sensuren GmbH (Valeo), which aggregated $374,000 for the three months ended June 30, 2008, compared to $436,000 in the corresponding period of the prior fiscal year.

Contract revenues increased 25.4% to $6.9 million for the three months ended June 30, 2008, compared to $5.5 million in the corresponding period of the prior fiscal year. This increase was largely due to increased funding at the federal, state and local levels throughout the country, as well as new contract awards. In response to this growth in funding, we have increased our Transportation Systems staff by 7% in the three months ended June 30, 2008, and we expect to continue to increase our Transportation Systems staff over the remainder of fiscal 2009. 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 approximately $11 million in new contracts awarded to us during the first quarter 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.

Although we are not aware of any imminent changes in government spending patterns, it is conceivable that, as a result of softening macroeconomic conditions in the U.S. and the decline in the new housing market, 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 possible that future domestic Roadway Sensors net sales or Transportation System contract revenues would be adversely affected.

Gross Profit. Total gross profit increased 9.3% to $7.8 million for the three months ended June 30, 2008, as compared to $7.1 million in the corresponding period of the prior fiscal year. Total gross profit as a percent of net sales and contract revenues decreased slightly to 44.4% for the three months ended June 30, 2008, as compared to 45.0% in the corresponding period of the prior fiscal year.

Gross profit as a percent of net sales was 50.0% for the three months ended June 30, 2008, compared to 49.5% in the corresponding period of the prior fiscal year. This increase in gross profit was primarily a result of increased gross profit in the Vehicle Sensors segment, largely as a result of the continued expansion of our Vehicle Sensors customer base as well as improved production efficiencies. Roadway Sensors gross profit as a percent of net sales was relatively flat compared to the prior year. 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 twelve quarters from a high of 50.2% in the first quarter of fiscal 2006 to a low of 39.2% reported in the third quarter of fiscal 2007.

Gross profit as a percent of contract revenues was 36.0% for the three months ended June 30, 2008, compared to 36.7% in the corresponding period 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 decrease in gross profit as a percent of contract revenues for the three months ended June 30, 2008 reflects a contract mix weighted more toward lower margin contracts in the period. Lower margin contracts generally have a higher proportion of sub-consulting revenues associated with them.

Selling, General and Administrative Expense. Selling, general and administrative expense increased 14.9% to $5.2 million (or 29.6% of total net sales and contract revenues) in the three months ended June 30, 2008, compared to $4.5 million (or 28.5% of total net sales and contract revenues) in the corresponding period of the prior fiscal year. This increase was largely attributable to higher selling expenses in our Transportation Systems segment aimed at capturing additional contract backlog in the current quarter as well as increased general and administrative expenses related to our efforts to comply with the internal control attestation requirements of the Sarbanes-Oxley Act, with which we began to comply in fiscal 2008.

Research and Development Expense. Research and development expense increased 21.7% to $1.2 million (or 6.9% of total net sales and contract revenues) for the three months ended June 30, 2008, compared to $1.0 million (or 6.3% of total net sales and contract revenues) in the corresponding period of the prior fiscal year. This increase 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, versus the prior year, for the remainder of fiscal 2009.

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

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

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
	(In thousands)	
Interest expense	**$ (130)**	$ (276)
Amortization of debt discount	**(41)**	(52)
Amortization of deferred finance costs	**(27)**	(35)
Interest expense, net	**$ (198)**	$ (363)

Interest expense decreased for the three months ended June 30, 2008 compared to the corresponding period in the prior fiscal year as a result of an overall lower level of borrowings.

Income Taxes. During the three months ended June 30, 2008, we recognized income tax expense of $491,000 as compared to income tax expense of $134,000 in the corresponding period of the prior fiscal year, resulting in an effective tax rate of 42.4% for the three months ended June 30, 2008, versus an effective tax rate of 10.9% in the corresponding period of the prior fiscal year. The increase in our effective tax rate in the current year period was primarily due to an adjustment of the valuation allowance recorded against our deferred tax assets in the prior year period as a result of changes in our estimates of the future realizability of these assets. The company analyzes its tax estimates quarterly, and should those estimates result in an increase in future taxable income, we may continue to record similar adjustments to our deferred tax asset valuation allowance, which totaled approximately $8.0 million at June 30, 2008. This may 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 equity securities. We currently rely on cash flows from operations and borrowings on a line of credit facility to fund our operations. At June 30, 2008, we had $8.7 million in working capital, which included $7.8 million attributable to outstanding convertible debentures, no borrowings on our $10.0 million line of credit and $68,000 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. The company is evaluating various financing alternatives to re-finance the convertible debentures should they not convert to common stock, and expects to have a financing structure in place before they become due in May 2009.

Our operating activities used $666,000 in cash during the three months ended June 30, 2008, primarily as a result of increases in trade accounts receivable balances, which was largely attributable to the timing of invoicing in Transportation Systems. During the three months ended June 30, 2007, our operations provided $1.9 million of cash, primarily as a result of net income generated during the period as well as, to a lesser extent, the timing of cash flows from operating assets and liabilities.

Our investing activities for the three months ended June 30, 2008 and 2007 consisted entirely of purchases of property and equipment, which aggregated $257,000 and $137,000, respectively.

Cash provided by financing activities was $570,000 in the three months ended June 30, 2008, which was primarily the result of $514,000 in proceeds from the exercise of outstanding stock options to purchase our common stock. During the three months ended June 30, 2007, financing activities provided $453,000 of cash, which was largely the result of $726,000 in proceeds from the exercise of outstanding stock options to purchase our common stock, partially offset by net payments on borrowing of $273,000.

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Borrowings

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

	At June 30, 2008 (In thousands)
Convertible debentures, net	$ 7,607
Other	23
	$ 7,630

In October 2006, we entered into a two-year credit facility with a bank. The credit facility provides for line of credit borrowings of up to $10.0 million against our eligible accounts receivable and inventory, as defined in the credit agreement. The interest rate on the line of credit is the current stated prime rate plus 1.00%. We are obligated to pay an unused line fee of 0.25% per annum applied to the amount by which the maximum credit amount exceeds the average daily principal balance during the preceding month. The credit facility also requires $2,000 in monthly collateral management fees and includes an early termination fee equal to 1% of the total facility. The credit facility is secured by substantially all of the assets of the Company. At June 30, 2008, we had $9.9 million available under our credit facility, all of which was unused.

We believe that the cash generated from our operations, together with funds available under our credit agreement, will be sufficient to fund our operations for at least the next twelve months. The company is evaluating various financing alternatives and expects to have a new credit facility to replace our current facility upon its expiration in October 2008. However, should a shortfall occur, or if we are unsuccessful in obtaining a new credit facility, we may need to raise additional funds through other debt financings or the sale of equity securities.

Contractual Obligations

Our contractual obligations were as follows at June 30, 2008:

	Payments Due by Fiscal Year (In thousands)						
	2009	2010	2011	2012	2013	Thereafter	Total
Notes payable	$ 23	$	$	$	$	$	$ 23
Convertible debentures		7,750					7,750
Operating leases	1,398	1,544	1,412	1,332	1,363	2,460	9,509
Total	$ 1,421	$ 9,294	$ 1,412	$ 1,332	$ 1,363	$ 2,460	$ 17,282

At June 30, 2008, we had firm commitments to purchase inventory in the amount of $1.6 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 19, 2009 and are convertible into shares of our common stock at an initial conversion price of $3.61 per share. At June 30, 2008, $7.8 million of these convertible debentures remained outstanding. 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 June 30, 2008, outstanding warrants to purchase an aggregate of 246,250 shares of our common stock at an exercise price of $3.25 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 $3.25 per share, we are a party to certain registration rights agreements that contain 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 EITF 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 agreements associated with these warrants.

Rule 10b5-1 Trading Plan

One of our executive officers, Francis Memole, 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 103,578 shares of our common stock.

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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. Our line of credit bears interest based on the prevailing prime rate (5.00% at June 30, 2008). We do not believe that a 10% increase in the interest rate on our line of credit (from 6.00% to 6.60%) 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 approximates fair value.

ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Controls

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth under Note 4 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item I of this report, is incorporated herein by reference.

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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.

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 (Fiscal 2007). Additionally, prior to the replacement of our prior credit facility in October 2006, we failed to meet certain debt covenants under that credit agreement during two fiscal quarters. Furthermore, as of June 30, 2008, we had $7.8 million in subordinated convertible debentures outstanding that are due in full in May 2009. Should the holders of the convertible debentures not elect to convert the principal into shares of our common stock, we may need to raise additional capital to refinance this debt.

At June 30, 2008, we had $68,000 of cash and cash equivalents and relied on our line of credit to fund our operations. We may need to raise additional capital in the near future to fund our operations or to repay indebtedness. Such additional capital may be raised through bank borrowings, or other debt or equity financings. We cannot assure you that any additional capital will be available on a timely basis, on acceptable terms, or at all, and such additional financing may result in further dilution to our stockholders.

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

- market acceptance of our products and product enhancements, and the overall level of sales of our products;
- our ability to control costs;
- the supply of key components for our products;

- our ability to increase revenue and net income;
- increased research and development expenses and sales and marketing expenses;
- our need to respond to technological advancements and our competitors introductions of new products or technologies;
- capital improvements to new and existing facilities and enhancements to our infrastructure and systems;
- potential acquisitions of businesses and product lines;
- our relationships with customers and suppliers;
- 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.

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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.

An Economic Slowdown Could Lead To Reduced Or Delayed Government Funding For Transportation Infrastructure And Initiatives And Decreased Availability Of Financial Capital For Our Customers, Causing A Decline In Our Revenues. Concerns about inflation, decreased consumer confidence, and reduced corporate profits and capital spending have resulted in a downturn in worldwide economic conditions, particularly in the United States. These unfavorable economic conditions may have a negative impact on customer orders (and also may result in decreased sales of automobiles and trucks that incorporate our LDW systems). 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 construction, has adversely impacted new road construction and could result in a decline in Roadway Sensor and Vehicle Sensor net sales and 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 and could result in a decline in our net sales and contract revenues. If such conditions continue or worsen, our business, financial condition and results of operations could be materially and adversely affected.

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;

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- the impact of international conflicts;

- performance bond requirements;

- changes in government policies and political agendas;

- delays in funding, including the delays in the allocation of funds to state and local agencies from the U.S. federal government as a result of a reduction or a delay in the passage of the 2005 Federal Highway Bill, which is set to expire in 2009;

- other government budgetary constraints and cut-backs; and

- 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 Which 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 increase 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.

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.

New Environmental Regulations May Result In A Decline In Our AutoVue Sales and Royalties. Environmental regulations in Europe were modified and became effective in 2006, which required more stringent emissions compliance in new trucks manufactured in Europe after 2006. These regulations caused the cost of certain trucks to increase significantly and caused a decline in new truck sales in Europe. Similar regulations were exacted in North America that impacted diesel engines built after January 2007. North America heavy truck sales in 2007 and the first two quarters of 2008 declined significantly as compared to the prior year, which we believe was at least in part a result of large 2006 prebuys of heavy trucks made in anticipation of the new North America emission standards. We may experience a further decline in our LDW sales to truck OEMs related to these stricter regulations. Additionally, we may experience future declines in our LDW sales to truck OEMs as a result of future regulations such as these.

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.

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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.

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.

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 larger company during Fiscal 2007, who in July 2008 sold its in-vehicle vision business to a multi-national manufacturer and supplier of in-vehicle saftey products. 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 OEM s. These OEM s 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.

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

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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.

We Have Historically Experienced Substantial Losses And May Experience Losses In The Future. Although we have achieved net income in our prior 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.

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.

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

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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.

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 effecting our revenue and operations.

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 for consulting contracts or intersection maintenace and upgrades;
- declines in new home construction and related road 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;

- our ability to develop, introduce, patent, market and gain market acceptance of new products, applications and product enhancements in a timely manner, or at all;

- market acceptance of the products incorporating our technologies and products;

- the introduction of new products by competitors;

- the availability and cost of components used in the manufacture of our products;

- our success in expanding and implementing our sales and marketing programs;

- the effects of technological changes in our target markets;

- the amount of our backlog at any given time;

- the nature of our government contracts;

- deferrals of customer orders in anticipation of new products, applications or product enhancements;
- 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.

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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.

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.

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.

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 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

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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.

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 issues;
- 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 that 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.

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 June 30, 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 June 30, 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.

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Certain Anti-Takeover Provisions May Affect The Price Of Our Common Stock And Discourage A Third Party From Acquiring Us.
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 could be used to 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

None.

ITEM 6. EXHIBITS

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

Exhibit Number	Description	Where Located
3.1	Amended and Restated Certificate of Incorporation of the registrant	*Exhibit 3.1 to the registrant s Current Report on Form 8-K as filed with the SEC on October 28, 2004*
3.2	Certificate of Amendment to Amended and Restated Certificate of Incorporation filed September 26, 2007	*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*
3.3	Bylaws of registrant, as amended	*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*
3.4	Certificates of Amendment to Bylaws of the registrant dated April 24, 1998 and August 10, 2001	*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*
3.5	Certificate of Amendment to Bylaws of registrant dated September 9, 2004	*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*
3.6	Certificate of Amendment to Bylaws of registrant dated September 16, 2005	*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*
3.7	Certificate of Amendment to Bylaws of registrant dated December 7, 2007	*Exhibit 3.1 to the registrant s Current Report on Form 8-K as filed with the SEC on December 13, 2007*
4.1	Specimen of Common Stock Certificate	*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*

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31.1	Certification of the Principal Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	*Filed herewith*
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: July 31, 2008	ITERIS, INC. (Registrant)	
	By	/S/ ABBAS MOHADDES