ITERIS, INC.
Form 10-Q
August 05, 2011
Table of Contents

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, 2011

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)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 31, 2011, there were 34,379,076 shares of common stock outstanding.

Table of Contents

ITERIS, INC.

Quarterly Report on Form 10-Q
For the Three Months Ended June 30, 2011

Table of Contents

PART I.	**FINANCIAL INFORMATION**	3
ITEM 1.	FINANCIAL STATEMENTS	3
	UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS AT JUNE 30, 2011 AND MARCH 31, 2011	3
	UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2011 AND 2010	4
	UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE THREE MONTHS ENDED JUNE 30, 2011 AND 2010	5
	NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS	6
ITEM 2.	MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	16
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	24
ITEM 4.	CONTROLS AND PROCEDURES	24
PART II.	**OTHER INFORMATION**	25
ITEM 1.	LEGAL PROCEEDINGS	25
ITEM 1A.	RISK FACTORS	25
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	34
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	34
ITEM 4.	(REMOVED AND RESERVED)	34
ITEM 5.	OTHER INFORMATION	34
ITEM 6.	EXHIBITS	35

Unless otherwise indicated in this report, the Company, we, us and our refer to Iteris, Inc. and our wholly-owned subsidiaries, Iteris Europe GmbH and Meridian Environmental Technology, Inc.

Iteris®, Vantage®, VantageView , VersiCam , SafetyDirect and Abacus are among the trademarks of Iteris, Inc. Any other trademarks or trade names mentioned herein are the property of their respective owners.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Iteris, Inc.

Unaudited Condensed Consolidated Balance Sheets

(In thousands, except par value)

	June 30, 2011	March 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 11,440	$ 11,818
Trade accounts receivable	11,912	10,941
Costs in excess of billings on uncompleted contracts	3,934	4,070
Inventories	3,655	3,680
Deferred income taxes	2,864	2,927
Prepaid expenses and other current assets	452	432
Total current assets	34,257	33,868
Property and equipment, net	2,403	2,607
Deferred income taxes	10,807	10,807
Intangible assets, net	1,744	1,850
Goodwill	21,270	21,270
Other assets	205	203
Total assets	$ 70,686	$ 70,605
Liabilities and stockholders equity		
Current liabilities:		
Trade accounts payable	$ 4,124	$ 3,412
Accrued payroll and related expenses	3,606	3,538
Accrued liabilities	3,106	3,387
Billings in excess of costs and estimated earnings on uncompleted contracts	1,257	1,335
Current portion of long-term debt	2,324	2,324
Total current liabilities	14,417	13,996
Long-term debt	182	640
Deferred rent	972	1,058
Unrecognized tax benefits	583	587
Other non-current liabilities	1,048	1,028
Total liabilities	17,202	17,309
Commitments and contingencies		
Stockholders equity:		
Common stock $0.10 par value, 70,000 shares authorized, 34,366 and 34,364 shares issued and outstanding at June 30, 2011 and March 31, 2011, respectively	3,437	3,436
Additional paid-in capital	138,028	137,938
Accumulated deficit	(87,981)	(88,078)
Total stockholders equity	53,484	53,296
Total liabilities and stockholders equity	$ 70,686	$ 70,605

See accompanying notes.

Table of Contents

Iteris, Inc.

Unaudited Condensed Consolidated Statements of Operations

(In thousands, except per share amounts)

	Three Months Ended June 30, 2011		Three Months Ended June 30, 2010	
Net sales and contract revenues:				
Net sales	$	8,970	$	9,462
Contract revenues		6,997		6,212
Total net sales and contract revenues		15,967		15,674
Costs of net sales and contract revenues:				
Cost of net sales		4,558		4,520
Cost of contract revenues		4,867		4,137
Gross profit		6,542		7,017
Operating expenses:				
Selling, general and administrative		5,135		4,641
Research and development		1,080		941
Amortization of intangible assets		106		36
Change in fair value of contingent acquisition consideration		17		
Total operating expenses		6,338		5,618
Operating income		204		1,399
Non-operating income (expense):				
Other income, net		3		1
Interest expense, net		(29)		(40)
Income before income taxes		178		1,360
Provision for income taxes		(81)		(563)
Net income	$	97	$	797
Net income per share:				
Basic	$	0.00	$	0.02
Diluted	$	0.00	$	0.02
Weighted-average shares outstanding:				
Basic		34,365		34,329
Diluted		34,559		34,692

See accompanying notes.

Table of Contents

Iteris, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(In thousands)

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010
Cash flows from operating activities		
Net income	$ 97	$ 797
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in deferred tax assets	63	467
Depreciation of property and equipment	269	244
Stock-based compensation	88	91
Amortization of intangible assets	106	36
Change in fair value of contingent acquisition consideration	17	
Changes in operating assets and liabilities:		
Accounts receivable	(971)	(288)
Net costs and estimated earnings in excess of billings	58	(220)
Inventories	25	(316)
Prepaid expenses and other assets	(22)	(78)
Accounts payable and accrued expenses	661	1,183
Net cash provided by operating activities	391	1,916
Cash flows from investing activities		
Purchases of property and equipment	(65)	(101)
Cash paid for business combination	(137)	
Net cash used in investing activities	(202)	(101)
Cash flows from financing activities		
Payments on long-term debt	(458)	(457)
Deferred payment for prior business combination	(112)	(106)
Proceeds from stock option exercises	3	19
Net cash used in financing activities	(567)	(544)
Increase (decrease) in cash and cash equivalents	(378)	1,271
Cash and cash equivalents at beginning of period	11,818	10,405
Cash and cash equivalents at end of period	$ 11,440	$ 11,676

See accompanying notes.

Table of Contents

Iteris, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2011

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Iteris, Inc. (including our subsidiaries, referred to collectively in these consolidated financial statements as Iteris, the Company, we, our and u is a leader in the traffic management market focused on the development and application of advanced technologies that reduce traffic congestion and improve the safety of surface transportation systems infrastructure. Additionally, we believe our products and services, in conjunction with sound traffic management, minimize the environmental impact of traffic congestion. By combining outdoor image processing, traffic engineering and information technology, we offer a broad range of Intelligent Transportation Systems (ITS) and driver safety solutions to customers in the United States (U.S.) and internationally. Iteris was originally incorporated in Delaware in 1987.

Basis of Presentation

Our unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and with the instructions to Securities and Exchange Commission (SEC) Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of Iteris as of June 30, 2011, the consolidated results of operations for the three months ended June 30, 2011 and 2010 and the consolidated cash flows for the three months ended June 30, 2011 and 2010. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. The results of operations for the three months ended June 30, 2011 are not necessarily indicative of those to be expected for future quarterly periods or the entire fiscal year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended March 31, 2011, which was filed with the SEC on June 1, 2011.

Use of Estimates

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

Revenue Recognition

Net Sales

Product revenues and related costs of sales are recognized when all of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the price to the customer is fixed or determinable, and (iv) collection of the receivable is reasonably assured. These criteria are typically met at the time of product shipment, but in certain circumstances, may not be met until receipt or acceptance by the customer. Accordingly, at the date revenue is recognized, the significant obligations or uncertainties concerning the sale have been resolved.

We recognize revenue from the sale of deliverables that are part of a multiple-element arrangement in accordance with applicable accounting guidance that establishes a selling price hierarchy permitting the use of an estimated selling price to determine the allocation of arrangement consideration to a deliverable in a multiple-element arrangement where neither vendor specific objective evidence (VSOE) nor third-party evidence (TPE) of fair value is available for that deliverable. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, we are required to estimate the selling prices of those elements. Overall arrangement consideration is allocated to each element (both delivered and undelivered items) that has stand-alone value based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on our estimated selling prices.

Table of Contents

We account for multiple-element arrangements that consist only of software and software-related services in accordance with applicable accounting guidance for software and software-related transactions. For such transactions, revenue on arrangements that include multiple elements is allocated to each element based on the relative fair value of each element, and fair value is determined by VSOE. If we cannot objectively determine the fair value of any undelivered element included in such multiple-element arrangements and the only undelivered element is post-contract customer support or maintenance, and VSOE of the fair value of such support or maintenance does not exist, revenue from the entire arrangement is recognized ratably over the support period. When the fair value of a delivered element has not been established, but VSOE of fair value exists for the undelivered elements, we use the residual method to recognize revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered element and is recognized as revenue.

We also derive revenue from the provision of specific non-recurring contract engineering services and royalties. Non-recurring contract engineering revenues are recognized in the period in which the related services are performed. Royalty revenues are recorded in the period in which the royalty is earned based on unit sales of certain of our products. Non-recurring contract engineering and royalty revenues are included in net sales in the accompanying unaudited condensed consolidated statements of operations.

Contract Revenues

Contract revenues are derived primarily from long-term contracts with governmental agencies. The majority of our contract revenues are recognized using the percentage of completion method of accounting, whereby costs incurred plus a portion of estimated fees or profits are determined based on the relationship of costs incurred 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. Certain of our contract revenues are recognized as services are performed and amounts are earned, which is measured by time incurred or other contractual milestones or output measures. Contract revenues accounted for in this manner generally relate to certain cost-plus fixed fee or time-and-materials contracts for which no specific maximum contract values are stipulated.

Costs in Excess of Billings on Uncompleted Contracts

Costs in excess of billings on uncompleted contracts in the accompanying unaudited condensed consolidated balance sheets represent unbilled amounts earned and reimbursable under services sales arrangements. At any given period-end, a large portion of the balance in this account represents the accumulation of labor, materials and other costs that have not been billed due to timing, whereby the accumulation of each month s costs and earnings are not administratively billed until the subsequent month. Also included in this account are amounts that become billable according to contract terms, which usually consider the passage of time, achievement of milestones or completion of the project. Generally, such unbilled amounts will be billed and collected within the next twelve months.

Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts

Billings in excess of costs and estimated earnings on uncompleted contracts in the accompanying unaudited condensed consolidated balance sheets is comprised of cash collected from customers and billings to customers on contracts in advance of work performed, advance payments negotiated as a contract condition, estimated losses on uncompleted contracts, project-related legal liabilities and other project-related reserves. The majority of the unearned amounts are expected to be earned within the next twelve months.

We record provisions for estimated losses on uncompleted contracts in the period in which such losses become known. The cumulative effects of revisions to contract revenues and estimated completion costs are recorded in the accounting period in which the amounts become evident and can be reasonably estimated. These revisions can include such items as the effects of change orders and claims, warranty claims, liquidated damages or other contractual penalties, adjustments for audit findings on United States (U.S.) or other government contracts and contract closeout settlements.

Foreign Currency

We have determined that the functional currency of our subsidiary in Europe is the U.S. dollar. Local currency financial statements are remeasured into U.S. dollars at the exchange rate in effect as of the balance sheet date for monetary assets and liabilities and the historical exchange rate for nonmonetary assets and liabilities. Revenues and expenses are remeasured using the average exchange rate for the period, except items related to nonmonetary assets and liabilities, which are remeasured using historical exchange rates. Remeasurement gains and losses are reported in other income, net in the accompanying unaudited condensed consolidated statements of operations.

Table of Contents

Concentration of Credit Risk

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

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

Our accounts receivable are derived from revenues earned from customers located throughout North America, and to a lesser extent from customers in Europe, Asia, South America and the Middle East. We generally do not require collateral or other security from customers. We maintain an allowance for doubtful accounts for potential credit losses, which losses have historically been within management s expectations.

Fair Values of Financial Instruments

The fair value of cash and cash equivalents, receivables, accounts payable and accrued expenses approximate carrying value because of the short period of time to maturity. The fair value of line of credit agreements and long-term debt approximate carrying value because the related effective rates of interest approximate current market rates available to us for debt with similar terms and similar remaining maturities.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term investments with initial maturities of ninety days or less.

Allowance for Doubtful Accounts

The collectability of our accounts receivable is evaluated through review of invoices outstanding greater than a certain period of time and ongoing credit evaluations of our customers financial condition. In cases where we are aware of circumstances that may impair a specific customer s ability to meet its financial obligations subsequent to the original sale, we will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount we reasonably believe will be collected. We also maintain an allowance based on our historical collections experience. When we determine that collection is not likely, we write off accounts receivable against the allowance for doubtful accounts.

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

Goodwill and Long-Lived Assets

Goodwill is tested for impairment on an annual basis in our fourth fiscal quarter or more frequently if indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of our reporting units with each respective reporting unit s carrying amount, including goodwill. We determine the fair value of reporting units using the income approach with a reconciliation of the total reporting unit fair value to our total market capitalization. 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 and an impairment charge is recorded for any excess carrying amount over fair value. We monitor the indicators for goodwill impairment testing between annual tests. Certain adverse business conditions impacting one or more reporting units would cause us to test goodwill for impairment on an interim basis. We also evaluate long-lived assets for impairment 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 of undiscounted expected future cash flows to the carrying value of the related net assets. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using discounted expected future cash flows and a discount rate based upon our weighted average cost of capital adjusted for risks associated with the related operations. Impairment is based on the excess of the carrying amount over the fair value of those assets.

Table of Contents

Income Taxes

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

We must review all of our tax positions and make a determination as to whether each position is more-likely-than-not to be sustained upon examination by taxing authorities. If a tax position meets the more-likely-than-not standard, then the related tax benefit is measured based on a cumulative probability analysis of the amount that is more-likely-than-not to be realized upon effective settlement or disposition of the underlying issue.

Stock-Based Compensation

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

Research and Development Expenditures

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

Shipping and Handling Costs

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

Sales Taxes

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

Warranty

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

Repair and Maintenance Costs

We incur repair and maintenance costs in the normal course of business. Should the activity result in a permanent improvement to our property or equipment or one of our leased facilities, the cost is capitalized 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.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04), which amends Accounting Standards Codification 820, *Fair Value Measurements*. ASU 2011-04 aims to eliminate certain differences that existed between U.S. and international fair value accounting concepts, and also clarifies existing guidance in U.S. GAAP. Additionally, among other disclosures, the ASU requires certain new quantitative and qualitative disclosures regarding unobservable fair value measurements. We will be required to adopt the amendments prescribed by ASU 2011-04 for our fiscal year beginning April 1, 2012. We have not yet evaluated the impact of its adoption on our consolidated financial statements.

Table of Contents

2. Supplemental Financial Information

Inventories

The following table presents details of our inventories:

	June 30, 2011	March 31, 2011
	(In thousands)	
Materials and supplies	$ 2,717	$ 2,668
Work in process	159	128
Finished goods	779	884
	$ 3,655	$ 3,680

Intangible Assets

The following table presents details of our intangible assets:

	June 30, 2011		March 31, 2011	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Intangible assets subject to amortization:				
Developed technology	$ 1,566	$ (768)	$ 1,566	$ (719)
Patents	317	(317)	317	(312)
Customer contracts / relationships	500	(42)	500	(21)
Other	550	(62)	550	(31)
Total	$ 2,933	$ (1,189)	$ 2,933	$ (1,083)

We do not have any intangible assets with indefinite useful lives. As of June 30, 2011, future estimated amortization expense is as follows:

Year Ending March 31: **(In thousands)**	
Remainder of 2012	$ 303
2013	404
2014	387
2015	237

2016		229
Thereafter		184
	$	1,744

If we acquire additional intangible assets in future periods, our future amortization expense will increase.

Table of Contents

Warranty Reserve Activity

The following table presents activity related to the warranty reserve:

	Three Months Ended June 30, 2011	2010
	(In thousands)	
Balance at beginning of period	$ 385	$ 468
Additions charged to cost of sales	53	38
Warranty claims	(43)	(30)
Balance at end of period	$ 395	$ 476

Comprehensive Income

Comprehensive income is equal to net income for all periods presented in the accompanying unaudited condensed consolidated statements of operations.

Net Income Per Share

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

	Three Months Ended June 30, 2011	2010
	(In thousands, except per share amounts)	
Numerator:		
Net income	$ 97	$ 797
Denominator:		
Weighted average common shares used in basic computation	34,365	34,329
Dilutive stock options	171	360
Dilutive restricted stock units	23	
Dilutive warrants		3
Weighted average common shares used in diluted computation	34,559	34,692
Net income per share:		
Basic	$ 0.00	$ 0.02
Diluted	$ 0.00	$ 0.02

The following instruments were excluded for purposes of calculating weighted average common share equivalents in the computation of diluted net income per share as their effect would have been anti-dilutive:

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010
	(Shares in thousands)	
Stock options	2,170	860
Warrants	15	321

3. Fair Value Measurements

We measure fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value measurements are based on a three-tier hierarchy that prioritizes the inputs used to measure fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets for identical assets and liabilities; Level 2, defined as observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities or prices quoted in inactive markets; and Level 3, defined as unobservable inputs that are significant to the fair value of the asset or liability, and for which little or no market data exists, therefore requiring management to utilize its own assumptions to provide its best estimate of what market participants would use in valuing the asset or liability.

Table of Contents

The liability for the estimated fair value of the contingent consideration in connection with our acquisition of Meridian Environmental Technology, Inc. (MET) was determined using Level 3 inputs based on a probabilistic calculation whereby we assigned estimated probabilities to achieving the earn-out targets and then discounted the total contingent consideration to net present value. The following table reconciles this liability measured at fair value on a recurring basis for the three months ended June 30, 2011 (in thousands):

Balance at April 1, 2011	$	2,528
Change in fair value included in net income		17
Balance at June 30, 2011	$	2,545

The current and non-current portions of the liability are included within accrued liabilities and other non-current liabilities, respectively, in the accompanying unaudited condensed consolidated balance sheets at June 30, 2011 and March 31, 2011. The change in the estimated fair value of the liability for the three months ended June 30, 2011 is included as part of operating expenses in the accompanying unaudited condensed consolidated statement of operations.

Other than the above, we did not have any material financial assets or liabilities measured at fair value on a recurring basis using Level 3 inputs as of June 30, 2011 or March 31, 2011.

Our non-financial assets, such as goodwill, intangible assets and property and equipment, are measured at fair value on a non-recurring basis, generally when there is a transaction involving those assets such as a purchase transaction, a business combination or an adjustment for impairment. No non-financial assets were measured at fair value during the three months ended June 30, 2011 and 2010.

4. Revolving Line of Credit and Long-Term Debt

Revolving Line of Credit

We currently maintain a credit facility that provides for (i) a revolving line of credit, expiring on October 1, 2012, with borrowings of up to $12.0 million and (ii) a $7.5 million term note (discussed below). Interest on borrowed amounts under the revolving line of credit are payable monthly at a rate equal to the current stated prime rate (3.25% at June 30, 2011) up to the current stated prime rate plus 0.50%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. We are obligated to pay an unused line fee of 0.25% per annum applied to the average unused portion of the revolving line of credit during the preceding month. The revolving line of credit does not contain any early termination fees and is secured by substantially all of our assets. As of June 30, 2011, no amounts were borrowed under the revolving line of credit portion of the facility. Availability under this line of credit may be reduced or otherwise limited as a result of our obligations to comply with certain financial covenants.

Long-Term Debt Bank Term Note

As of June 30, 2011, we had outstanding borrowings of approximately $2.5 million under our bank term note, which expires on May 1, 2013. Principal payments under this term note are required to be repaid in 48 monthly installments of $152,000 commencing on June 1, 2009. Additionally, beginning on November 1, 2009, and on November 1 of each year thereafter, we are required to repay additional principal of up to $500,000, calculated based on certain financial measures, as further defined in the agreement. These additional principal payments effectively reduce the total number of monthly installments necessary to repay the term note. As of June 30, 2011 and March 31, 2011, an additional $500,000 was included in the current portion of the term note within the accompanying unaudited condensed consolidated balance sheets, representing the amount we estimate will be due on November 1, 2011. Interest on the term note is payable monthly at a rate equal to the current stated prime rate plus 0.50% up to the current stated prime rate plus 1.00%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. The term note contains no early termination fees and, along with the revolving line of credit under the same credit agreement, is secured by substantially all of our assets.

Table of Contents

5. Income Taxes

The following table sets forth our provision for income taxes, along with the corresponding effective tax rates:

	Three Months Ended June 30, 2011	2010
	(In thousands, except percentages)	
Provision for income taxes	$ 81	$ 563
Effective tax rate	45.5%	41.4%

On an interim basis, we estimate what our anticipated annual effective tax rate will be, while also separately considering applicable discrete and other non-recurring items, and record a quarterly income tax provision in accordance with the anticipated annual rate. As the fiscal year progresses, we refine our estimates based on actual events and financial results during the year. This process can result in significant changes to our expected effective tax rate. When this occurs, we adjust our income tax provision during the quarter in which our estimates are refined so that the year-to-date provision reflects the expected annual effective tax rate. These changes, along with adjustments to our deferred taxes, among others, may create fluctuations in our overall effective tax rate from quarter to quarter. We have not recorded any valuation allowance against our deferred tax assets as of June 30, 2011 and March 31, 2011.

6. Commitments and Contingencies

Litigation and Other Contingencies

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

Related Party Transaction

In August 2009, MAXxess Systems, Inc. (MAXxess) executed a promissory note payable to Iteris for $274,000 for amounts previously owed to us under a sublease agreement for which we had previously fully reserved such amount. MAXxess is owned by an investor group that includes two of our directors. As of June 30, 2011, approximately $16,000 of accrued interest along with the entire $274,000 principal balance was outstanding and payable to Iteris, all of which remains fully reserved.

7. Employee Benefit Plans

We currently administer three separate stock incentive plans. Of these plans, we may only grant future awards from the 2007 Omnibus Incentive Plan (the 2007 Plan). The 2007 Plan allows for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units (RSUs) and other stock-based awards. At June 30, 2011, there were 649,000 shares of common stock available for grant under the 2007 Plan.

Table of Contents

Stock Options

A summary of activity with respect to our stock options for the three months ended June 30, 2011 is as follows:

	Number of Shares (In thousands)	Weighted-Average Exercise Price Per Share
Options outstanding at March 31, 2011	3,111	$ 1.59
Granted	20	1.37
Exercised	(2)	1.19
Forfeited	(6)	1.41
Expired	(12)	2.23
Options outstanding at June 30, 2011	3,111	$ 1.58

Included in the options outstanding at June 30, 2011 are vested options to purchase 719,000 shares of our common stock with an exercise price per share of $1.19, which are scheduled to expire in September 2011 unless exercised prior to that date.

Restricted Stock Units

As of June 30, 2011, there were 214,000 RSUs outstanding. These RSUs are stock awards that entitle the holder to receive shares of our common stock upon vesting. The RSUs vest at the rate of 25% per year beginning in August 2011.

Stock-Based Compensation Expense

The following table presents stock-based compensation expense that is included in each functional line item on our unaudited condensed consolidated statements of operations:

	Three Months Ended June 30,	
	2011	2010
	(In thousands)	
Cost of net sales	$ 3	$ 2
Cost of contract revenues	8	8
Selling, general and administrative expense	67	74
Research and development expense	10	7

	$	88	$	91

At June 30, 2011, there was approximately $533,000 of unrecognized compensation expense related to unvested stock options and RSUs. This expense is currently expected to be recognized over a weighted average period of approximately 2.3 years. If there are any modifications or cancellations of the underlying unvested awards, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that we grant additional stock options, RSUs or other stock-based awards.

Table of Contents

The grant date fair value per share of stock options granted in the three months ended June 30, 2011 has been estimated using the following weighted average assumptions:

Expected life - years		7
Risk-free interest rate		2.8%
Expected volatility of common stock		53%
Dividend yield		
Weighted-average grant date fair value per share	$	0.77

8. Business Segment Information

During the three months ended June 30, 2011, and partially driven by the sale of substantially all of the assets of our Vehicle Sensors segment (see Note 9 below), we reevaluated and reorganized our operating segments. As a result, through June 30, 2011, we now operate in three reportable segments: Roadway Sensors, Vehicle Sensors and Transportation Systems. The Roadway Sensors segment includes our Vantage and VersiCam vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications. This segment also includes our Pico compact video detection system, which is a vehicle detection system designed primarily to respond to international video detection needs. The Vehicle Sensors segment includes our lane departure warning products and is comprised of all of our activities related to vehicle safety; however, as a result of the sale of substantially all of the assets of this segment in July 2011, we will no longer operate in the Vehicle Sensors segment. The Transportation Systems segment includes transportation engineering and consulting services and the development of transportation management and traveler information systems for the ITS industry. This segment is also comprised of the operations of MET, which specializes in 511 advanced traveler information systems by offering a unique range of customer-specific environmental and operational forecasting products and services, and offers Maintenance Decision Support System management tools that allow users to create solutions to meet roadway maintenance decision needs.

The accounting policies of our reportable segments are the same as those described in the summary of significant accounting policies (Note 1). Certain corporate expenses, including interest and amortization of intangible assets, are not allocated to the segments. The reportable segments are each managed separately because they manufacture and distribute distinct products or provide services with different processes. All segment revenues are derived from external customers.

The following table sets forth selected unaudited consolidated financial information for our reportable segments for the three months ended June 30, 2011 and 2010:

		Roadway Sensors		Vehicle Sensors (In thousands)		Transportation Systems		Total
Three Months Ended June 30, 2011								
Product revenue	$	6,895	$	2,000	$		$	8,895
Service and other revenue				75		6,997		7,072
Segment income (loss)		915		(323)		138		730

Three Months Ended June 30, 2010				
Product revenue	$ 7,693	$ 1,628	$	$ 9,321
Service and other revenue		141	6,212	6,353
Segment income (loss)	1,370	(182)	313	1,501

Table of Contents

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

	Three Months Ended June 30, 2011	2010
	(In thousands)	
Segment income:		
Total income from reportable segments	$ 730	$ 1,501
Unallocated amounts:		
Corporate and other expenses	(403)	(66)
Amortization of intangible assets	(106)	(36)
Change in fair value of contingent acquisition consideration	(17)	
Other income, net	3	1
Interest expense, net	(29)	(40)
Income before income taxes	$ 178	$ 1,360

9. Subsequent Event

On July 25, 2011, we entered into an Asset Purchase Agreement (the Agreement) with Bendix Commercial Vehicle Systems LLC, a member of Knorr-Bremse Group (Bendix). Subject to the satisfaction or waiver of the conditions to closing included in the Agreement, we will sell to Bendix substantially all of its assets used in connection with the Company s Vehicle Sensors segment. On July 29, 2011, we completed the sale.

Under the terms of the Agreement, on July 29, 2011 Bendix paid us $14 million, subject to a $2 million holdback and adjustments based upon the working capital of the Vehicle Sensors segment at closing, and assumed certain specified obligations and liabilities of the Vehicle Sensors segment. We are entitled to additional consideration in the form of certain performance and royalty-related earn-outs. Bendix will pay to Iteris an amount in cash equal to (i) 85% of revenue associated with royalties received under our license and distribution agreements with Audiovox Electronics Corporation and Valeo Schalter und Sensoren GmbH through December 31, 2017 and (ii) 30% of the amount, if any, by which the amount of revenue generated from the sale of our lane departure warning systems exceeds Bendix s projection for such revenue for the two years following closing, each subject to certain reductions and limitations set forth in the Agreement.

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 growth, sales, revenue, expenses, profits, capital needs, competition, development plans, and manufacturing capabilities, the applications for and acceptance of our products and services, and the status of our facilities and product development. These statements are not guarantees of future performance and are subject to certain risks and uncertainties that could cause our actual results to differ materially from those projected. You should not place undue reliance on these forward-looking statements that speak only as of the date hereof. We encourage you to carefully review and consider the various disclosures made by us which describe certain factors which could affect our business, including in Risk Factors set forth in Part II, Item 1A of this report, before deciding to invest in our company or to maintain or increase your investment. We undertake no obligation to revise or update publicly any forward-looking statement for any reason, including to reflect events or circumstances after the date hereof or to reflect the *occurrence of unanticipated events.*

Overview

General. We are a leader in the traffic management market focused on the development and application of advanced technologies that reduce traffic congestion and improve the safety of surface transportation systems infrastructure. Additionally, we believe our products and services, in conjunction with sound traffic management, minimize the environmental impact of traffic congestion. By combining outdoor image processing, traffic engineering and information technology, we offer a broad range of Intelligent Transportation Systems and driver safety solutions to customers in the U.S. and internationally.

Table of Contents

Acquisitions and Divestitures. In January 2011, we acquired all of the capital stock of Meridian Environmental Technology, Inc. (MET) for an initial cash payment of approximately $1.6 million. We also agreed to pay up to $1 million on each of the first two anniversaries of the closing of the acquisition, as well as up to an additional $2 million under a 24-month earn-out provision.

In April 2009, we completed the acquisition of certain assets of Hamilton Signal, which included the Abacus system, for an aggregate purchase price of approximately $518,000.

On July 25, 2011, we entered into an Asset Purchase Agreement (the Agreement) with Bendix Commercial Vehicle Systems LLC, a member of Knorr-Bremse Group (Bendix). Subject to the satisfaction or waiver of the conditions to closing included in the Agreement, we will sell to Bendix substantially all of its assets used in connection with the Company s Vehicle Sensors segment. On July 29, 2011, we completed the sale.

Under the terms of the Agreement, on July 29, 2011 Bendix paid us $14 million, subject to a $2 million holdback and adjustments based upon the working capital of the Vehicle Sensors segment at closing, and assumed certain specified obligations and liabilities of the Vehicle Sensors segment. We are entitled to additional consideration in the form of certain performance and royalty-related earn-outs. Bendix will pay to Iteris an amount in cash equal to (i) 85% of revenue associated with royalties received under our license and distribution agreements with Audiovox Electronics Corporation and Valeo Schalter und Sensoren GmbH through December 31, 2017 and (ii) 30% of the amount, if any, by which the amount of revenue generated from the sale of our lane departure warning systems exceeds Bendix s projection for such revenue for the two years following closing, each subject to certain reductions and limitations set forth in the Agreement.

Business Segments. During the three months ended June 30, 2011, and partially driven by the sale of substantially all of the assets of our Vehicle Sensors segment (as described above), we reevaluated and reorganized our operating segments. As a result, through June 30, 2011, we now operate in three reportable segments: Roadway Sensors, Vehicle Sensors and Transportation Systems.

Roadway Sensors

Our Roadway Sensors segment product line uses advanced image processing technology to capture and analyze video images through sophisticated algorithms, enabling vehicle detection and transmission of both video images and data using various communication technologies.

- Our Vantage video detection systems detect vehicle presence at intersections, as well as vehicle count, speed and other traffic data used in traffic management systems. Our Vantage systems give traffic managers the ability to mitigate roadway congestion by modifying traffic signal timing or detecting incidents quickly. Our VantageView software supplements our Vantage video detection systems by providing an integrated platform to manage and see video detection assets remotely over a network connection.

- VersiCam, our integrated camera and processor video detection system, is a cost-efficient video detection system for smaller intersections that require only a few detection points.

- Pico, our compact video detection system, was developed primarily to address international video detection needs, and was designed for easy installation and configuration.

- Our Abacus products take advantage of the large number of existing installed closed-circuit television video feeds monitoring roadways, signalized intersections, tunnels and bridges to allow for data collection and incident detection without the set-up and calibration generally required with other systems.

We believe that future growth domestically and internationally, particularly in developing countries, will be dependent in part on the continued adoption of above-ground video detection technologies, instead of traditional in-pavement loop technology, to manage traffic.

Vehicle Sensors

Our Vehicle Sensors segment addresses the leading cause of roadway fatalities: lane change, roadway departure and rear-end collision accidents. We developed the world s first production lane departure warning (LDW) system and offer a proven system that is available as an OEM and aftermarket option on heavy trucks worldwide and as an option in certain passenger cars. Our LDW products utilize video detection images to detect when a vehicle begins to drift toward an unintended lane change. When this occurs, the unit automatically emits a distinctive rumble strip or other audible warning sound, alerting the driver to make a correction. In 2003 we entered into an exclusive license of our LDW technology to our strategic partner, Valeo Schalter and Sensoren GmbH (Valeo) to pursue opportunities in the passenger car market. We anticipate this license will be assigned to the buyer of this segment in the VS Sale if such divestiture is completed.

Table of Contents

In addition to our LDW systems, our Vehicle Sensors segment includes radar-based Forward Collision Warning and Blind Spot Warning systems for the North American truck market, and our SafetyDirect product, a system that reports driver performance data captured by our LDW system, and has the ability to relay this data directly to fleet operators through integration with the truck s existing fleet communications system.

As a result of the July 29, 2011 sale of substantially all of the assets of this segment, we will no longer operate in the Vehicle Sensors segment.

Transportation Systems

Our Transportation Systems segment includes transportation engineering and consulting services focused on the planning, design, development and implementation of software-based systems that integrate sensors, video surveillance, computers, and advanced communications equipment to enable public agencies to monitor, control and direct traffic flow, assist in the quick dispatch of emergency crews and distribute real-time information about traffic conditions. Our services include planning, design and implementation of surface transportation infrastructure systems. We perform analysis and study goods movement, commercial vehicle operations, travel demand forecasting and systems engineering, and identify mitigation measures to reduce traffic congestion. This segment also includes the activities of MET, which we acquired in January 2011. The MET activities specialize in 511 advanced traveler information systems by offering a unique range of customer-specific environmental and operational forecasting products and services. It also utilizes certain internally developed systems and tools as the model for the 511 National Guidelines, and currently delivers a combination of customized route-specific surface weather, travel times and road condition reports statewide across various states in the U.S. We also provide Maintenance Decision Support System (MDSS) management tools that allow users to create solutions to meet roadway maintenance decision needs. MDSS provides detailed and accurate information at the route level that enables the efficient maintenance of roads and highways while optimizing resource use and reducing costs.

Our Transportation Systems segment is largely dependent upon governmental funding and is affected by state and local budgetary issues. We believe the overall expansion of our Transportation Systems segment in the future will at least in part be dependent on the passage of a new Federal Highway Bill, on which Congress is currently working. We anticipate continued delays in the enactment of such a new bill, and until such time as a bill becomes law, the allotment of transportation funds in federal, state and local budgets may be uncertain. We believe that prolonged uncertainty has adversely impacted, and may continue to adversely impact, our net sales and contract revenues and our overall financial performance in future periods.

Critical Accounting Policies and Estimates

Management s Discussion and Analysis of Financial Condition and Results of Operations is based on our unaudited consolidated financial statements included herein, which have been prepared in accordance with accounting principles generally accepted in the United States. 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 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 amounts of assets and liabilities at the date of the financial statements and the reported amounts of 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, intangible assets, 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, 2011 (fiscal 2011). There have been no significant changes in our critical accounting policies and estimates during the three months ended June 30, 2011 as compared to what was previously disclosed in our Annual Report on Form 10-K for fiscal 2011.

Table of Contents

Recent Accounting Pronouncements

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

Results of Operations

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

	Three Months Ended June 30, 2011	2010
Net sales and contract revenues:		
Net sales	56.2%	60.4%
Contract revenues	43.8	39.6
Total net sales and contract revenues	100.0%	100.0%
Costs of net sales and contract revenues:		
Cost of net sales	28.5	28.8
Cost of contract revenues	30.5	26.4
Gross profit	41.0	44.8
Operating expenses:		
Selling, general and administrative	32.2	29.6
Research and development	6.8	6.0
Amortization of intangible assets	0.7	0.2
Change in fair value of contingent acquisition consideration	0.1	
Total operating expenses	39.7	35.8
Operating income	1.3	8.9
Non-operating income (expense):		
Other income, net	0.0	0.0
Interest expense, net	(0.2)	(0.3)
Income before income taxes	1.1	8.7
Provision for income taxes	(0.5)	(3.6)
Net income	0.6%	5.1%

Analysis of Quarterly Results of Operations

Net Sales and Contract Revenues**.** Net sales are comprised of product sales from our Roadway Sensors and Vehicle Sensors segments, as well as contract engineering revenue and royalty revenue generated from our Vehicle Sensors segment. Contract revenues consist of revenues from our Transportation Systems segment.

19

Table of Contents

The following table presents details of our net sales and contract revenues for the three months ended June 30, 2011 and 2010:

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Increase (Decrease)	% Change
	(In thousands, except percentages)			
Roadway Sensors	$ 6,895	$ 7,693	$ (798)	(10.4)%
Vehicle Sensors	2,075	1,769	306	17.3
Net sales	8,970	9,462	(492)	(5.2)
Contract revenues	6,997	6,212	785	12.6
Total net sales and contract revenues	$ 15,967	$ 15,674	$ 293	1.9

We have historically had a diverse customer base. For the three months ended June 30, 2011 and 2010, no individual customer represented greater than 10% of our total net sales and contract revenues.

Roadway Sensors

The decrease in Roadway Sensors total net sales for the three months ended June 30, 2011 as compared to the corresponding period in the prior year was primarily attributable to timing, whereby the shipment of several significant customer orders that were booked in the current quarter did not ship as of June 30, 2011 and are expected to ship in a subsequent quarter. Additionally, in the prior year quarter our total net sales were boosted by significant shipments to certain international customers, which we did not expect to recur. Despite the year over year decline, net sales of our Roadway Sensors products increased sequentially for the third quarter in a row. Going forward, we plan to continue to invest in R&D and sales and marketing in our efforts to continue the trend of sequential growth.

Vehicle Sensors

Vehicle Sensors net sales were substantially made up of sales of our LDW systems to the heavy truck market. As compared to the prior year period, the increase in sales in the three months ended June 30, 2011 was primarily driven by strong sales domestically to various truck fleet customers. As a redult of the July 29, 2011 sale of substantially all of the assets of this segment, we will no longer operate in the Vehicle Sensors segment.

Contract Revenues

Our contract revenues are primarily dependent upon the continued availability of funding at the local, state and federal levels from the various agencies and departments of transportation. Contract revenues for the three months ended June 30, 2011 include $1.1 million of revenues attributable to MET. Excluding revenues from MET, our contract revenues from our Transportation Systems segment totaled $5.9 million for the three months ended June 30, 2011, an approximately 5% decrease from the $6.2 million in contract revenues in the prior year period. Overall, we believe this slight decrease continues to be primarily the result of uncertainty and weakness in the markets this segment serves, which has generally increased the length of the overall sales cycle.

Going forward, we plan to continue to pursue larger contracts that may contain significant sub-consulting content, which will likely contribute to variability in the timing and amount of our contract revenues from period to period. We also intend to continue to expand our foreign operations by pursuing additional international opportunities in the Middle East and other regions. Among other factors, we believe the ability of our Transportation Systems segment to grow and successfully win and service new contracts will be highly dependent upon our continued success in recruiting and retaining qualified personnel, as well as due to government funding initiatives in the markets we serve.

Table of Contents

Gross Profit. The following table presents details of our gross profit for the three months ended June 30, 2011 and 2010:

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Decrease	% Change
	(In thousands, except percentages)			
Total gross profit	$ 6,542	$ 7,017	$ (475)	(6.8)%
Total gross profit as a % of total net sales and contract revenues	41.0%	44.8%		
Gross profit as a % of net sales	49.2%	52.2%		
Gross profit as a % of contract revenues	30.4%	33.4%		

Our total gross profit and total gross profit as a percentage of total net sales and contract revenues decreased for the three months ended June 30, 2011 as compared to the corresponding period in the prior year primarily as a result of our product and service mix. Our net sales, which are substantially comprised of product sales, represented approximately 56% of our total net sales and contract revenues in the current period as compared to 60% in the prior year period. Our product net sales generally carry higher margins than our contract revenues derived from our consulting services.

The decrease in gross profit as a percent of net sales (gross margin) for the three months ended June 30, 2011 as compared to the corresponding period in the prior year was primarily a result of the mix of product sales in our Vehicle Sensors segment more weighted towards the new third generation lane departure warning unit which, at low volume production levels, carries a higher manufacturing cost. Our gross margin can fluctuate in any specific quarter or year based on, among other factors, customer and product mix, competitive pricing requirements, product warranty costs and provisions for excess and obsolete inventories, as well as shifts of engineering resources from development activities to sustaining activities, which we record as cost of goods sold.

We recognize the majority of our 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. Gross profit as a percent of contract revenues for the three months ended June 30, 2011 was lower than the comparable prior year period primarily due to lower margins stemming from seasonality and the related timing of certain of our MDSS and weather forecasting services revenues in the spring and summer time periods. Also, the overall mix of contract revenues in the current quarter contained a higher proportion of lower margin sub-consulting content. We expect to experience variability and related timing of contract mix and related sub-consulting content in our Transportation Systems segment in future periods, as well as factors such as paid holidays and our ability to efficiently utilize our workforce, will cause fluctuations in our margins from contract revenues from period to period.

Selling, General and Administrative Expense. The following table presents selling, general and administrative expense for the three months ended June 30, 2011 and 2010:

	Three Months Ended June 30, 2011		Three Months Ended June 30, 2010			
	Amount	% of Net Sales and Contract Revenues	Amount	% of Net Sales and Contract Revenues	Increase (Decrease)	% Change
	(In thousands, except percentages)					

Salary and personnel-related	$	3,558	22.3%	$	3,239	20.7%	$	319	9.8%
Facilities, insurance and supplies		491	3.1		643	4.1		(152)	(23.6)
Professional and outside services		606	3.8		418	2.7		188	45.0
Travel and conferences		466	2.9		410	2.6		56	13.7
Other		14	0.1		(69)	-0.4		83	120.3
Selling, general and administrative	$	5,135	32.2%	$	4,641	29.6%	$	494	10.6

The overall increase in selling, general and administrative expense for the three months ended June 30, 2011 as compared to the corresponding period in the prior year was primarily due to (i) higher salary and headcount-related expenses as we have added certain key sales and marketing personnel, as well as personnel added as a result of the MET acquisition, and (ii) legal and professional services related to the VS Sale, and certain other corporate initiatives. Additionally, in the three months ended June 30, 2011 and 2010, we realized approximately $80,000 and $200,000, respectively, in reversals of previously recorded bad debt expense

Table of Contents

(included in the Other category in the table above) primarily as a result of collecting certain large accounts receivable balances. In prior periods, we had recorded an estimated allowance for doubtful accounts against these receivables given the uncertainty of collection at that time. In the future, our operating results in any given period may be favorably or adversely impacted as a result of our estimates of the realization of our accounts receivable.

Research and Development Expense. The following table presents research and development expense for the three months ended June 30, 2011 and 2010:

	Three Months Ended June 30, 2011		Three Months Ended June 30, 2010		
		% of Net Sales and Contract		% of Net Sales and Contract	%