

ITERIS, INC.  
Form 10-K  
June 07, 2013  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-08762

# ITERIS, INC.

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction  
of Incorporation or Organization)

**95-2588496**  
(I.R.S. Employer  
Identification No.)

**1700 Carnegie Ave., Santa Ana, California 92705**

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: **(949) 270-9400**

Securities registered pursuant to Section 12(b) of the Act:

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Common Stock, \$0.10 par value	NYSE MKT

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Based on the closing sale price of the registrant's common stock on the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting common stock held by nonaffiliates of the registrant was approximately \$31,897,000. For the purposes of this calculation, shares owned by officers, directors and 10% stockholders known to the registrant have been deemed to be owned by affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of May 28, 2013, there were 32,645,241 shares of our common stock outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates by reference certain information from the registrant's definitive proxy statement for the 2013 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended March 31, 2013. Except with respect to information specifically incorporated by reference in this report, the registrant's proxy statement is not deemed to be filed as a part hereof.

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**ITERIS, INC.**

**ANNUAL REPORT ON FORM 10-K**

**FOR THE FISCAL YEAR ENDED MARCH 31, 2013**

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Unless otherwise indicated in this report, the Company, we, us and our refer to Iteris, Inc. and its wholly-owned subsidiaries.

Iteris®, Vantage®, iPerform®, Abacus®, Vantage Vector®, Edge®, VersiCam , Pico , SmartCycle , SmartScan , iPeMS , RZ-4 , EdgeConnect and VantageView 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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**Cautionary Statement**

*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), could, should, 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, profitability, capital needs, backlog and manufacturing capabilities, competition, the impact of any current or future litigation, the impact of recent accounting pronouncements, 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 I, 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.*

**PART I**

**ITEM 1. BUSINESS**

**Overview**

We are a leading provider of intelligent information solutions to the traffic management market. We are focused on the development and application of advanced technologies and software-based information systems that reduce traffic congestion, provide measurement, management and predictive traffic analytics and improve the safety of surface transportation systems infrastructure. We also believe our products, services and solutions, in conjunction with sound traffic management, minimize the environmental impact of traffic congestion. We combine our unique intellectual property, products, decades of experience in traffic management and information technologies to offer a broad range of Intelligent Transportation Systems ( ITS ) solutions to customers worldwide.

We were originally incorporated in Delaware in 1987. Our principal executive offices are located at 1700 Carnegie Avenue, Santa Ana, California 92705, and our telephone number at that location is (949) 270-9400. Our Internet website address is [www.iteris.com](http://www.iteris.com). Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, together with amendments to these reports, are available on the Investors section of our website, free of charge, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission ( SEC ). The inclusion of our website address in this report does not include or incorporate by reference into this report any information on, or accessible through, our website.

**Products and Services**

We currently operate in three reportable segments: Roadway Sensors, Transportation Systems and iPerform. The Roadway Sensors segment includes, among other products, our Vantage, VersiCam, Pico, Vantage Vector, SmartCycle, SmartScan and Abacus vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications. 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 also includes 511 advanced traveler information systems and offers our weather related Maintenance Decision Support System management tools that allow users to create solutions to meet roadway maintenance decision needs. The iPerform segment includes our transportation performance measurement and information management solutions. The iPerform performance measurement solutions leverage its real-time data collection, diagnostic, fusion and warehousing platform to aggregate and compute performance measurements. See Note 13 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report, for further details on our reportable segments.

*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.

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- 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. Vantage video detection systems typically include up to four of our RZ-4 Advanced cameras or our RZ-4 Advanced Wide Dynamic Range cameras and an EdgeConnect processor. 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.
- Our Vantage Vector product is an all-in-one vehicle detection sensor with a wide range of capabilities including: stop bar detection, advanced-zone detection, and sensing that enables advanced safety and adaptive control applications. It includes all the proven benefits of Iteris video detection, including high accuracy, high availability remote viewing of video images, no trenching or pavement cutting for installation, bicycle detection capability and high precision for dilemma zone detection by integrating the video field-of-view with radar sensing. Enhanced information includes the number of vehicles, speed, and distance in user configurable zones that can be used for special applications.
- Our SmartSpan product uses proprietary Dynamic Zone Stabilization algorithms and provides accurate and cost effective advance detection and stop-bar detection of vehicles at intersections equipped with span wire mounted signal lights. SmartSpan can be mounted on the same span wires holding the traffic signal without sacrificing detection accuracy.
- Our Vantage systems equipped with SmartCycle can effectively differentiate between bicycles and other vehicles with a single video detection camera, enabling more efficient signalized intersections and maximized traffic throughput. Agencies using bicycle timing can now benefit from bicycle-specific virtual detection zones that can be placed anywhere within the approaching traffic lanes, eliminating the need for separate bicycle-only detection systems.
- 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 designed to monitor 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.



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We have historically experienced seasonality, particularly with respect to our Roadway Sensors revenues in our third and fourth fiscal quarters due to reductions in road construction and repairs during the winter months related to inclement weather conditions.

### *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, study commercial vehicle operations, provide travel demand forecasting and systems engineering, and identify mitigation measures to reduce traffic congestion. This segment also includes the activities of Meridian Environmental Technology, Inc. ( MET ), acquired by us in January 2011, which specializes in 511 advanced traveler information systems as well as Maintenance Decision Support System ( MDSS ) management tools that allow users to create solutions to meet roadway maintenance decision needs.

Our Transportation Systems segment is largely dependent upon governmental funding and is affected by state and local budgetary issues. We expect the recently enacted federal highway bill, which provides for an estimated \$105 billion in federal funding for highway, transit, safety, and related transportation programs through the end of September 2014, should make funds more available for transportation infrastructure, traffic management and performance measurement projects. This bill could encourage government agencies to include ITS technologies in these types of projects to a greater degree than in previous

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legislation. In addition, various other funding mechanisms exist to support transportation infrastructure and related projects. These include bonds, dedicated sales and gas tax measures and other alternative funding sources. We believe the overall expansion of our Transportation Systems segment in the future will at least in part be dependent on the federal governments' use of funds under the federal highway bill. Delays in the release of funding may prolong uncertainty regarding the allotment of transportation funds in federal, state and local budgets. We believe that prolonged uncertainty has adversely impacted, and may continue to adversely impact, our Transportation Systems revenues and our overall financial performance in future periods.

With the addition of MET in January 2011, we have experienced seasonality particularly related to certain MDSS services in our first and second fiscal quarters mainly because MDSS services are generally not required in the summer months when weather conditions are typically less severe.

*iPerform*

Our iPerform segment, formed during the first quarter of our fiscal year ended March 31, 2013 ( Fiscal 2013 ), includes our performance measurement and information management solutions, including all of the operations of Berkeley Transportation Systems, Inc. ( BTS ), acquired by us in November 2011, which specializes in transportation performance measurement. The BTS performance measurement system leverages its real-time data collection, diagnostic, fusion and warehousing platform to aggregate and compute performance measurements. During the fiscal year ended March 31, 2012 ( Fiscal 2012 ), we began the development of IterisPeMS, which is a state-of-the-art information management software suite that utilizes a wide range of data resources and analytical techniques to determine current and future traffic patterns, permitting the effective performance analysis and management of traffic infrastructure resources. This information can then be analyzed by traffic professionals to measure how a transportation network is performing and to identify potential areas of improvement. IterisPeMS is also capable of providing users with traffic predictive analytics and easy-to-use visualization and animation features based on historical traffic conditions.

iPerform is a market leader in performance management solutions for federal, state, local and municipal organizations. We intend to use its strong brand and deep experience in the traffic management market, as well as its market-specific intellectual property, to expand our leadership in data aggregation and analytics. By increasing investments in both technical and market development, we plan to focus on expanding the scope of its public sector solutions into the commercial marketplace.

Going forward, iPerform's solutions are expected to include incident management applications, arterial solutions, predictive traffic, and weather-based data and analytics for both public and commercial markets, including media, automotive, and consumer applications. We plan to fund these investments through internally generated cash flow from our Roadway Sensors and Transportation Systems operating segments, as well as revenues from our iPerform segment and our available cash if necessary.

**Sales, Marketing and Principal Customers**

We sell our Roadway Sensors products through direct and indirect sales channels. In the territories where we sell direct, we use a combination of our own sales personnel and an outside sales organization to sell, oversee installations and set-up issues and support our products. Our indirect sales channels are comprised of a network of independent dealers in the U.S. and certain foreign locations, who sell integrated systems and related products to the traffic management market. Our independent dealers are trained in, and primarily responsible for, sales, installation,

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set-up and support of our products, and maintain an inventory of demonstration traffic products from various manufacturers and sell directly to government agencies and installation contractors. These dealers often have long-term arrangements with local government agencies in their respective territories for the supply of various products for the construction and renovation of traffic intersections, and are generally well-known suppliers of high-quality ITS products to the traffic management market. We periodically hold technical training classes for our dealers and end users and maintain a full-time staff of customer support technicians throughout the U.S. to provide technical assistance when needed. When appropriate, we have the ability to modify or make changes to our dealer network to accommodate the needs of the market and our customer base.

We market and sell our Transportation Systems services and solutions and iPerform solutions directly to government agencies pursuant to negotiated contracts that involve competitive bidding and specific qualification requirements. Most of our contracts are with federal, state and municipal customers and generally provide for cancellation or renegotiation at the option of the customer upon reasonable notice and fees paid for modification. We generally use selected members of our engineering, science and information technology teams on a regional basis to serve in sales and business development functions. Our contracts generally involve long lead times and require extensive specification development, evaluation and price negotiations. Additionally, we plan to focus on expanding the scope of our iPerform public sector solutions to sell into the commercial marketplace.

A large portion of our revenues are derived from sales to federal, state and local government agencies. We currently have, and historically have had, a diverse customer base. For Fiscal 2013, one individual customer represented approximately 13% of our total revenues and no other individual customer represented greater than 10% of our total revenues. For Fiscal 2012 and our fiscal year

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ended March 31, 2011 ( Fiscal 2011 ), no individual customer represented greater than 10% of our total revenues. Also refer to Note 13 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report.

**Manufacturing and Materials**

We use contract manufacturers to build subassemblies that are used in our Roadway Sensors products. Additionally, we procure certain components from qualified suppliers, both locally and globally, and generally use multi-sourcing strategies when technically and economically feasible to mitigate supply risk. These subassemblies and components are typically delivered to our Santa Ana, California facility where they go through final assembly and testing prior to shipment to our customers. Our key suppliers include CTS Electronics Manufacturing Solutions, Inc., Sony Electronics, Inc. and LG Electronics, Inc. Our manufacturing activities are conducted in approximately 9,000 square feet of space at our Santa Ana facility. Production volume at our subcontractors is based upon quarterly forecasts that we generally adjust on a monthly basis to control inventory levels. We typically do not manufacture any of the hardware used in the transportation management and traveler information systems that we design and implement. Our production facility is currently ISO 9001 certified.

**Customer Support and Services**

We provide warranty service and support for our products, as well as follow-up service and support for which we charge separately. Such service revenue was not a material portion of our total revenues for each of Fiscal 2013, Fiscal 2012 and Fiscal 2011. We believe customer support is a key competitive factor.

**Backlog**

Our total backlog of unfulfilled firm orders was approximately \$38.6 million as of March 31, 2013, which was comprised of \$3.1 million related to Roadway Sensors, \$32.2 million related to Transportation Systems and \$3.3 million related to iPerform. Substantially the entire backlog for Roadway Sensors is expected to be recognized as revenue in the fiscal year ending March 31, 2014 ( Fiscal 2014 ). In the past three fiscal years, we have recognized approximately 50% to 70% of our Transportation Systems backlog as of the end of a fiscal year in the subsequent fiscal year, and currently expect that trend to continue for the near future for both Transportation Systems and iPerform.

At March 31, 2012, we had backlog of approximately \$35.0 million, which was comprised of \$3.2 million related to Roadway Sensors and \$31.8 million related to Transportation Systems.

The timing and realization of our backlog is subject to the inherent uncertainties of doing business with federal, state and local governments, particularly in view of budgetary constraints, cut-backs and other delays or reallocations of funding that these entities typically face.

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Pursuant to the customary terms of our agreements with government contractors and other customers, customers can generally cancel or reschedule orders with little or no penalties. Lead times for the release of purchase orders often depend upon the scheduling and forecasting practices of our individual customers, which also can affect the timing of the conversion of our backlog into revenues. For these reasons, among others, our backlog at a particular date may not be indicative of our future revenues, in particular for our Roadway Sensors segment.

### **Product Development**

Most of our product development activities are conducted at our principal facilities in Santa Ana, California. Our research and development costs and expenses were approximately \$3.1 million for Fiscal 2013, \$3.2 million for Fiscal 2012 and \$2.4 million for Fiscal 2011. We expect to continue to pursue various product development programs and incur research and development expenditures in future periods.

We believe our engineering and product development capabilities are a competitive strength. We strive to continue to develop new products to meet the needs of the ever-changing ITS market as well as enhance and refine our existing product lines. Since 2008 our Roadway Sensors segment has introduced our VersiCam and VersiCam wireless products, Pico, RZ-4 advanced camera and our RZ-4 advanced wide dynamic range camera, which significantly improve video detection performance in certain harsh lighting conditions. During Fiscal 2012, we introduced our Vantage Vector product and also upgraded our Abacus and VantageView software products. Additionally, during Fiscal 2012, we began development of our software based IterisPeMS performance measurement system, which continued through Fiscal 2013 and will continue during Fiscal 2014. We believe that developing new offerings across our segments and enhancing, refining and marketing our existing products is a key component of strong organic growth and profitability.

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**Competition**

We generally face significant competition in each of our target markets. Increased competition may result in price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on our business, financial condition and results of operations.

In the market for our Roadway Sensors vehicle detection products, we compete with manufacturers and distributors of other above ground video camera detection systems and other non-intrusive detection devices, including microwave, infrared, ultrasonic and magnetic detectors, as well as manufacturers and installers of in-pavement inductive loop products, which have historically, and currently continue to be, the predominant detection system in this market.

The markets in which our Transportation Systems segment operates is highly fragmented and subject to evolving national and regional quality, operations and safety standards. Our competitors vary in number, scope and breadth of the products and services they offer. Our competitors in advanced Transportation Systems include national corporations that generally offer expertise in traveler information, integration and transportation management. Our competitors in transportation engineering, planning and design include major regional firms, as well as many smaller local engineering firms.

The markets in which our iPeform segment operates vary from public sector customers who focus on performance measurement systems to help measure and manage the effectiveness of their transportation systems to commercial sector customers who ingest and disseminate traffic and weather related data, information and analytics through various consumer outlets. Our competitors vary in number, scope and breadth of the products and services they offer. In the public sector we compete with some of the same transportation engineering, planning and design firms that also compete with our Transportation Systems segment. In the commercial sector, we compete with a variety of entities that currently provide traffic and/or weather related data to that market.

In general, the markets for the products and services we offer are highly competitive and are characterized by rapidly changing technology and evolving standards. Many of our current and prospective competitors have longer operating histories, greater name recognition, access to larger customer bases and significantly greater financial, technical, manufacturing, distribution and marketing resources than us. As a result, they may be able to adapt more quickly to new or emerging standards or technologies or to devote greater resources to the promotion and sale of their products. It is also possible that new competitors or alliances among competitors could emerge and rapidly acquire significant market share. We believe that our ability to compete effectively in our target markets will depend on a number of factors, including the success and timing of our new product development, the compatibility of our products with a broad range of computing systems, product quality and performance, reliability, functionality, price and service and technical support. Our failure to provide services and develop and market products that compete successfully with those of other suppliers and consultants in our target markets would have a material adverse effect on our business, financial condition and results of operations.

**Intellectual Property and Proprietary Rights**

Our ability to compete effectively depends in part on our ability to develop and maintain the proprietary aspects of our technology. Our policy is to obtain appropriate proprietary rights protection for any potentially significant new technology acquired or developed by us. We currently hold

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three U.S. patents, four foreign patent applications, six patent applications in the United States ( U.S. ), and eight provisional patent filings. One U.S. patent, which expires in May 2019, is for general technology related to CMOS sensors. Two U.S. patents, which expire between 2014 and 2029, three foreign patent applications, three U.S. patent applications, and one provisional patent filing relate specifically to our Roadway Sensors technology. One pending foreign patent, three U.S. patent applications, and seven provisional patent filings relate specifically to our iPerform technology. We cannot be certain that any new patents will be granted pursuant to these or subsequent patent applications or provisional patent filings.

In addition to patent laws, we rely on copyright and trade secret laws to protect our proprietary rights. We attempt to protect our trade secrets and other proprietary information through agreements with customers and suppliers, proprietary information agreements with our employees and consultants, and other similar measures. We do not have any material licenses or trademarks other than those relating to product names. We cannot be certain that we will be successful in protecting our proprietary rights. While we believe our patents, patent applications, software and other proprietary know-how have value; changing technology makes our future success dependent principally upon our ability to successfully achieve continuing innovation.

Litigation may be necessary in the future to enforce our proprietary rights, to determine the validity and scope of the proprietary rights of others, or to defend us against claims of infringement or invalidity by others. An adverse outcome in such litigation or similar proceedings could subject us to significant liabilities to third parties, require disputed rights to be licensed from others or require us to cease marketing or using certain products, any of which could have a material adverse effect on our business, financial condition and results of operations. In addition, the cost of addressing any intellectual property litigation claim, both in legal

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fees and expenses, as well as from the diversion of management's resources, regardless of whether the claim is valid, could be significant and could have a material adverse effect on our business, financial condition and results of operations.

**Employees**

We refer to our employees as associates. As of March 31, 2013, we employed an aggregate of 258 associates, including 55 associates in general management, administration and finance; 24 associates in sales and marketing; 150 associates in engineering and product development; 14 associates in operations, manufacturing and quality assurance; and 15 associates in customer service. None of our associates are represented by a labor union, and we have never experienced a work stoppage. We believe our relations with our associates are good.

**Sale of Vehicle Sensors**

On July 29, 2011, we completed the sale of substantially all of the assets used in connection with our Vehicle Sensors segment to Bendix Commercial Vehicle Systems LLC ( "Bendix" ), a member of Knorr-Bremse Group, pursuant to an Asset Purchase Agreement signed on July 25, 2011 (the "Asset Sale" ). Upon closing, Bendix paid us \$14 million in cash, subject to a \$2 million holdback and adjustments based upon the working capital of the Vehicle Sensors segment at closing, and Bendix assumed certain specified obligations and liabilities of the Vehicle Sensors segment. In October 2012, we received approximately \$1.7 million in connection with the holdback provision. Furthermore, we are entitled to additional consideration in the form of certain performance and royalty-related earn-outs. As a result of the Asset Sale, we no longer operate in the Vehicle Sensors segment and we determined that the Vehicle Sensors segment, which previously constituted one of our operating segments, qualifies as a discontinued operation. Refer to Note 3 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report for additional discussion regarding the Asset Sale. The applicable financial results of the Vehicle Sensors segment through the closing of the Asset Sale have been reported as a discontinued operation for all periods presented.

**Government Regulation**

Our manufacturing operations are subject to various federal, state and local laws and regulations, including those restricting the discharge of materials into the environment. We are not involved in any pending or, to our knowledge, threatened governmental proceedings, which would require curtailment of our operations because of such laws and regulations. We continue to expend funds in connection with our compliance with applicable environmental regulations. These expenditures have not, however, been significant in the past, and we do not expect any significant expenditure in the near future. Currently, compliance with foreign laws has not had a material impact on our business and is not expected to have a material impact in the near future.



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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 subsequent reports on Forms 10-Q and 8-K, before deciding to buy, sell or hold our common stock. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. If any of these risks actually occurs, our business, financial condition, or results of operations could be seriously harmed. In that event, the market price for our common stock could decline and you may lose all or part of your investment.*

**The economic slowdown has reduced and delayed government funding for transportation infrastructure projects and initiatives, decreased availability of financial capital for our customers and adversely impacted real estate development, all of which have adversely impacted our revenues.** Decreased consumer spending, the failure of certain financial institutions and businesses, concerns about the availability and cost of credit, and reduced corporate profits and capital spending have resulted in a downturn in worldwide economic conditions, as well as budgetary shortfalls at all levels of government. These unfavorable economic conditions are having, and are expected to continue to have, a negative impact on customer orders and government funding of infrastructure projects incorporating our products and services. Such factors have resulted and may continue to result in delays, cancellations and rescheduling of backlog and customer orders. In addition, the decline in the U.S. real estate market, particularly in new home and commercial construction, has adversely impacted new road construction and has had and may continue to have adverse effects on revenues. Any of the foregoing economic conditions may adversely affect our revenues in future periods and make it extremely difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. Additionally, there was uncertainty in the past few years regarding allotment of government funds due to delays in the passage of a federal highway bill, which adversely impacted our revenues and overall financial performance. Despite the recently enacted federal highway bill, delays in the allocation of funds, the priority of infrastructure projects and the availability of funds for ITS related projects could continue to adversely impact our revenues and overall financial performance.

**Because we depend on government contracts and subcontracts, we face additional risks related to contracting with federal, state and local governments, including budgetary issues and fixed price contracts.** A significant portion of our revenues are derived from contracts with governmental agencies, either as a general contractor, subcontractor or supplier. We anticipate that revenue from government contracts will continue to remain a significant portion of our revenues. Government business is, in general, subject to special risks and challenges, including:

- delays in funding and uncertainty regarding the allocation of funds to state and local agencies from the U.S. federal government as a result of delays in the expenditures from the federal highway bill, as well as delays or reductions in other state and local funding dedicated for transportation and ITS projects;
  
- other government budgetary constraints, cut-backs, delays or reallocation of government funding;
  
- performance bond requirements;

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- long purchase cycles or approval processes;
- competitive bidding and qualification requirements;
- changes in government policies and political agendas;
- milestone requirements and liquidated damage provisions for failure to meet contract milestones; and
- international conflicts or other military operations that could cause the temporary or permanent diversion of government funding from transportation or other infrastructure projects.

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

In addition, a 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

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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 revenues in any given period. Our inability to address any of the foregoing concerns or the loss or renegotiation of any material government contract could seriously harm our business, financial condition and results of operations.

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

**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:

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