

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 <input type="radio"/>	Accelerated filer <input type="radio"/>
Non-accelerated filer <input type="radio"/> (Do not check if a smaller reporting company)	Smaller reporting company <input checked="" type="radio"/>

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:

- rapid technological advances;
- downward price pressures in the marketplace as technologies mature;
- changes in customer requirements;
- additional qualification requirements related to new products or components;
- frequent new product introductions and enhancements;
- inventory issues related to transition to new or enhanced models; and
- evolving industry standards and changes in the regulatory environment.

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Our future success will depend upon our ability to anticipate and adapt to changes in technology and industry standards, and to effectively develop, introduce, market and gain broad acceptance of new products and product enhancements incorporating the latest technological advancements.

**If we are unable to develop and introduce new products and product enhancements successfully and in a cost-effective and timely manner, or are unable to achieve market acceptance of our new products, our operating results would be adversely affected.** We believe our revenue growth and future operating results will depend on our ability to complete development of new products and enhancements, introduce these products in a timely, cost-effective manner, achieve broad market acceptance of these products and enhancements, and reduce our production costs. We cannot guarantee the success of these products, and we may not be able to introduce any new products, including the IterisPeMS software or any enhancements to our existing products on a timely basis, or at all. In addition, the introduction of any new products could adversely affect the sales of certain of our existing products.

We believe that we must continue to make substantial investments to support ongoing research and development in order to remain competitive. We need to continue to develop and introduce new products that incorporate the latest technological advancements in outdoor image processing hardware, software and camera technologies in response to evolving customer requirements. We cannot assure you that we will be able to adequately manage product transition issues. Our business and results of operations could be adversely affected if we do not anticipate or respond adequately to technological developments or changing customer requirements or if we cannot adequately manage inventory issues typically related to new product transitions and introductions. We cannot assure you that any such investments in research and development will lead to any corresponding increase in revenue.

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**We recently entered into the software development market and may be subject to additional challenges and additional costs and delays.**

We have only been in the business of software development for a few years and may experience development and technical challenges. Our business and results of operations could also be seriously harmed by any significant delays in our software development and updates. Certain of our new products could contain undetected design faults and software errors or bugs when first released by us, despite our testing. We may not discover these faults or errors until after a product has been installed and used by our customers. Any faults or errors in our existing products or in any new products may cause delays in product introduction and shipments, require design modifications or harm customer relationships, any of which could adversely affect our business and competitive position. We cannot assure you that our customer base will broadly accept any of our new products, product enhancements or software related offerings such as IterisPeMS. In addition, the software development industry can frequently experience litigation concerning intellectual property disputes, which could be costly and distract our management.

**The markets in which we operate are highly competitive and have many more established competitors, which could adversely affect our revenues or the market acceptance of our products.** We compete with numerous other companies in our target markets including, but not limited to, large, multinational corporations and many smaller regional engineering firms.

We compete with existing, well-established companies in our Roadway Sensors segment, both domestically and abroad. Certain technological barriers to entry make it difficult for new competitors to enter the market with competing video or other technologies; however, we are aware of new market entrants from time to time. Increased competition could result in loss of market share, price reductions and reduced gross margins, any of which could seriously harm our business, financial condition and results of operations.

The Transportation Systems market is highly fragmented and is subject to evolving national and regional quality and safety standards. Our competitors vary in size, number, scope and breadth of the products and services they offer, and include large multi-national engineering firms and smaller local regional firms.

The market for iPeform is nascent; however, we expect to compete with existing companies that are already providing consulting and traffic analytics services to public agencies, as well as certain companies performing real-time traffic collection data activities that we believe are attempting to provide related traffic analytics to public agencies. We cannot assure you that our iPeform solutions, including IterisPeMS, will be broadly accepted by the market and that competitors' software and analytics solutions will not take and/or gain market share. As such, increased competition in this area could result in loss of market share, price reductions and reduced gross margins, any of which could seriously harm this segment and our overall business.

In all of our segments, many of our competitors have far greater name recognition and greater financial, technological, marketing, and customer service resources than we do. This may allow them to respond more quickly to new or emerging technologies and changes in customer requirements. It may also allow them to devote greater resources to the development, promotion, sale and support of their products than we can. Consolidations of end users, distributors and manufacturers in our target markets exacerbate this problem. As a result of the foregoing factors, we may not be able to compete effectively in our target markets and competitive pressures could adversely affect our business, financial condition and results of operations.

**We may be unable to attract and retain key personnel, which could seriously harm our business.** Due to the specialized nature of our business, we are highly dependent on the continued service of our executive officers and other key management, engineering and technical personnel. The loss of any of our officers, or any of our other executives or key members of management could adversely affect our business, financial condition, or results of operations. Our success will also depend in large part upon our ability to continue to attract, retain and motivate

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qualified engineering and other highly skilled technical personnel. In particular, the future success of our Transportation Systems and iPerform segments will depend on our ability to hire additional qualified engineers, planners, software developers and technical personnel. Competition for qualified employees, particularly development engineers, is intense. We may not be able to continue to attract and retain sufficient numbers of such highly skilled employees. Our inability to attract and retain additional key employees or the loss of one or more of our current key employees could adversely affect our business, financial condition and results of operations.

**Our profitability could be adversely affected if we are not able to maintain adequate utilization of our Transportation Systems workforce.** The cost of providing our Transportation Systems engineering and consulting services, including the extent to which we utilize our workforce, affects our profitability. The rate at which we utilize our workforce is affected by a number of factors, including:

- our ability to transition employees from completed projects to new assignments and to hire and assimilate new employees;

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- our ability to forecast demand for our services and thereby maintain an appropriate headcount in our various regions;
- our need to devote time and resources to training, business development, professional development and other non-chargeable activities; and
- our ability to match the skill sets of our employees to the needs of the marketplace.

**Our failure to successfully bid on new contracts and renew existing contracts could reduce our revenues and profits.** Our business depends on our ability to successfully bid on new contracts and renew existing contracts with private and public sector customers. Contract proposals and negotiations are complex and frequently involve a lengthy bidding and selection process, which are affected by a number of factors, such as market conditions, financing arrangements and required governmental approvals. For example, a customer may require us to provide a surety bond or letter of credit to protect the client should we fail to perform under the terms of the contract. If negative market conditions continue, or if we fail to secure adequate financing arrangements or the required governmental approval or fail to meet other required conditions, we may not be able to pursue particular projects, which could reduce or eliminate our profitability.

**If we experience declining or flat revenues and we fail to manage such declines effectively, we may be unable to execute our business plan and may experience future weaknesses in our operating results.** Based on our business objectives, and in order to achieve future growth, we will need to continue to add additional qualified personnel, and invest in additional research and development and sales and marketing activities, which could lead to increases in our expenses and future declines in our operating results. In addition, our past expansion has placed, and future expansion is expected to place, a significant strain on our managerial, administrative, operational, financial and other resources. If we are unable to manage these activities or any revenue declines successfully, our growth, our business, our financial condition and our results of operations could continue to be adversely affected.

**We may be unable to maintain profitability on a quarterly or annual basis.** We cannot assure you that we will be able to sustain or improve our financial performance, or that we will be able to continue to achieve profitability on a quarterly or annual basis in the future. Our ability to maintain profitability in future periods could be impacted by budgetary constraints, government and political agendas, economic instability and other items that are not in our control. Furthermore, we rely on operating profits from the Company's segments to fund investments in sales and marketing and research and development initiatives. We cannot assure you that at any given time these profits will sustain a sufficient level to completely support those investments. Most of our expenses are fixed in advance. As such, we generally are unable to reduce our expenses significantly in the short-term to compensate for any unexpected delay or decrease in anticipated revenues or increases in planned investments. As a result, we may experience operating losses and net losses in the future, which would make it difficult to fund our operations and achieve our business plan, and could cause the market price of our common stock to decline.

**Our quarterly operating results fluctuate as a result of many factors. Therefore, we may fail to meet or exceed the expectations of securities analysts and investors, which could cause our stock price to decline.** Our quarterly revenues and operating results have fluctuated and are likely to continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. Factors that could affect our revenues include, among others, the following:

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- delays in government contracts and funding from time to time and budgetary constraints at the federal, state and local levels;
- our ability to access stimulus funding, funding from the federal highway bill or other funding;
- declines in new home and commercial real estate construction and related road and other infrastructure construction;
- changes in our pricing policies and the pricing policies of our suppliers and competitors, pricing concessions on volume sales, as well as increased price competition in general;
- the long lead times associated with government contracts;
- the size, timing, rescheduling or cancellation of significant customer orders;
- our ability to control costs;
- our ability to raise additional capital;



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- the mix of our products and services sold in a quarter, which has varied and is expected to continue to vary from time to time;
- seasonality due to winter weather conditions;
- seasonality with respect to revenues from our MDSS and related weather forecasting services due to the decrease in revenues generated for such services during the spring and summer time periods;
- our ability to develop, introduce, patent, market and gain market acceptance of new products, applications and product enhancements in a timely manner, or at all;
- market acceptance of the products incorporating our technologies and products;
- the introduction of new products by competitors;
- the availability and cost of components used in the manufacture of our products;
- our success in expanding and implementing our sales and marketing programs;
- the effects of technological changes in our target markets;
- the amount of our backlog at any given time;
- the nature of our government contracts;
- decrease in revenues derived from key or significant customers;

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- deferrals of customer orders in anticipation of new products, applications or product enhancements;
- risks and uncertainties associated with our international business;
- general economic and political conditions;
- international conflicts and acts of terrorism; and
- other factors beyond our control, including but not limited to, natural disasters.

Due to all of the factors listed above as well as other unforeseen factors, our future operating results could be below the expectations of securities analysts or investors. If that happens, the trading price of our common stock could decline. As a result of these quarterly variations, you should not rely on quarter-to-quarter comparisons of our operating results as an indication of our future performance.

**We may be subject to traffic related litigation.** The traffic industry in general is subject to litigation claims due to the nature of personal injuries that result from traffic accidents. As a provider of traffic engineering services, products and solutions, we are, and could in the future continue to be, from time to time, subject to litigation for traffic related accidents, even if our products or services did not cause the particular accident. While we generally carry insurance against these types of claims, some claims may not be covered by insurance or the damages resulting from such litigation could exceed our insurance coverage limits. In the event that we are required to pay significant damages as a result of one or more lawsuits that are not covered by insurance or exceed our coverage limits, it could materially harm our business, financial condition or cash flows. Even defending against unsuccessful claims could cause us to incur significant expenses and result in a diversion of management's attention.

**We may experience production gaps that could materially and adversely impact our sales and financial results and the ultimate acceptance of our products.** It is possible that we could experience unforeseen quality control issues or part shortages as we adjust production to meet current demand for our products. We have historically used single suppliers for certain significant components in our products. Should any such delay or disruption occur, or should a key supplier discontinue operations because of the current economic climate, our future sales will likely be materially and adversely affected. Additionally, we rely heavily on select contract manufacturers to produce many of our products and do not have any long-term contracts to guarantee supply of such products. Although we believe our contract manufacturers have sufficient capacity to meet our production schedules for the foreseeable future and we believe we could find alternative contract manufacturing sources for many of our products, if necessary, we could experience a production gap if for any reason our contract manufacturers were unable to meet our production requirements and our cost of goods sold could increase, adversely affecting our margins.

**Our use of the percentage of completion method of accounting for our Transportation Systems revenues could result in a reduction or reversal of previously recorded revenues and profits.** A significant portion of Transportation Systems revenues



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are measured and recognized using the percentage of completion method of accounting. Our use of this accounting method results in recognition of revenues and profits ratably over the life of a contract, based generally on the proportion of costs incurred to date to total costs expected to be incurred for the entire project. The effects of revisions to revenues and estimated costs are recorded when the amounts are known or can be reasonably estimated. Such revisions could occur in any period and their effects could be material. Although we have historically made reasonably reliable estimates of the progress towards completion of long-term engineering, program management, construction management or construction contracts, the uncertainties inherent in the estimating process make it possible for actual costs to vary materially from estimates, including reductions or reversals of previously recorded revenues and profits.

**We may engage in acquisitions of companies or technologies that may require us to undertake significant capital infusions and could result in disruptions of our business and diversion of resources and management attention.** We have completed three acquisitions since April 2009 and, in the future, we may acquire additional complementary businesses, products, and technologies. Acquisitions may require significant capital infusions and, in general, acquisitions also involve a number of special risks, including:

- potential disruption of our ongoing business and the diversion of our resources and management's attention;
- the failure to retain or integrate key acquired personnel;
- the challenge of assimilating diverse business cultures, and the difficulties in integrating the operations, technologies and information system of the acquired companies;
- increased costs to improve managerial, operational, financial and administrative systems and to eliminate duplicative services;
- the incurrence of unforeseen obligations or liabilities;
- potential impairment of relationships with employees or customers as a result of changes in management; and
- increased interest expense and amortization of acquired intangible assets, as well as unanticipated accounting charges.

Our competitors are also soliciting potential acquisition candidates, which could both increase the price of any acquisition targets and decrease the number of attractive companies available for acquisition. Acquisitions may also materially and adversely affect our operating results due to large write-offs, contingent liabilities, substantial depreciation, deferred compensation charges or intangible asset amortization, or other adverse tax or accounting consequences. We cannot assure you that we will be able to identify or consummate any additional acquisitions, successfully

integrate any acquisitions or realize the benefits anticipated from any acquisition.

**Our international business operations may be threatened by many factors that are outside of our control.** While we historically have had limited international sales, revenues and operations experience, we began work on our first overseas contracts in the United Arab Emirates in the fiscal year ended March 31, 2010. We plan to expand our international efforts in the future with respect to all of our segments, and in particular, plan to expand or distribution channels in Latin American and the Middle East in general. We cannot assure you that we will be successful in our expansion efforts. International operations subject us to various inherent risks including, among others:

- political, social and economic instability, as well as international conflicts and acts of terrorism;
- inability to satisfy bonding requirements for certain international projects;
- longer accounts receivable payment cycles;
- import and export license requirements and restrictions of the U.S. and each other country in which we operate;
- currency fluctuations and restrictions, and our ability to repatriate currency from certain foreign regions;
- unexpected changes in regulatory requirements, tariffs and other trade barriers or restrictions;

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- required compliance with existing and new foreign regulatory requirements and laws, more restrictive labor laws and obligations, including but not limited to the U.S. Foreign Corrupt Practices Act;
- difficulties in managing and staffing international operations;
- potentially adverse tax consequences; and
- reduced protection for intellectual property rights in some countries.

Substantially all of our international sales are denominated in U.S. dollars. As a result, an increase in the relative value of the dollar could make our products more expensive and potentially less price competitive in international markets. We do not currently engage in any transactions as a hedge against risks of loss due to foreign currency fluctuations.

Any of the factors mentioned above may adversely affect our future international revenues and, consequently, affect our business, financial condition and operating results. Additionally, as we pursue the expansion of our international business, certain fixed and other overhead costs could outpace our revenues, thus adversely affecting our results of operations. We may likewise face local competitors in certain international markets who are more established, have greater economies of scale and stronger customer relationships. Furthermore, as we increase our international sales, our total revenues may also be affected to a greater extent by seasonal fluctuations resulting from lower sales that typically occur during the summer months in Europe and other parts of the world.

**If our internal controls over financial reporting do not comply with the requirements of the Sarbanes-Oxley Act, our business and stock price could be adversely affected.** Section 404 of the Sarbanes-Oxley Act of 2002 currently requires us to evaluate the effectiveness of our internal controls over financial reporting at the end of each fiscal year and to include a management report assessing the effectiveness of our internal controls over financial reporting in all annual reports. As a smaller reporting company, for Fiscal 2013, we were exempt from the auditor attestation requirement over our internal control over financial reporting; however, to the extent we do not qualify as a non-accelerated filer or smaller reporting company in subsequent fiscal years, we will be subject to the auditor attestation requirement under Section 404(b) of the Sarbanes-Oxley Act. In such an event, we may not be able to complete the work required for such attestation on a timely basis and, even if we timely complete such requirements, our independent registered public accounting firm may still conclude that our internal controls over financial reporting are not effective.

Our management, including our CEO and CFO, does not expect that our internal controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Iteris have been or will be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure

you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, our controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**We may not be able to adequately protect or enforce our intellectual property rights, which could harm our competitive position.** If we are not able to adequately protect or enforce the proprietary aspects of our technology, competitors could be able to access our proprietary technology and our business, financial condition and results of operations will likely be seriously harmed. We currently attempt to protect our technology through a combination of patent, copyright, trademark and trade secret laws, employee and third party nondisclosure agreements and similar means. Despite our efforts, other parties may attempt to disclose, obtain or use our technologies or systems. Our competitors may also be able to independently develop products that are substantially equivalent or superior to our products or design around our patents. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the U.S. As a result, we may not be able to protect our proprietary rights adequately in the U.S. or abroad.

Litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation may also be necessary to defend against claims of infringement or invalidity by others. An adverse outcome in litigation or any similar proceedings could subject us to significant liabilities to third parties, require us to license disputed rights from others or require us to cease marketing or using certain products or technologies. We may not be able to obtain any licenses on terms acceptable to us, or at all. We also may have to indemnify certain customers or strategic partners if it is determined that we have infringed upon or misappropriated another party's intellectual property. Our recent expansion into software development activities may subject us to increased possibility of litigation. Any of the foregoing could adversely affect our business,

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financial condition and results of operations. In addition, the cost of addressing any intellectual property litigation claim, including legal fees and expenses, and the diversion of management's attention and resources, regardless of whether the claim is valid, could be significant and could seriously harm our business, financial condition and results of operations.

**We may need to raise additional capital in the future, which may not be available on terms acceptable to us, or at all.** We have historically experienced volatility in our earnings and cash flows from operations from year to year. Although we have a \$12.0 million revolving line of credit, should we have an event of default, which includes, among other things, a failure to meet certain financial covenants and a material adverse change in the business, the bank could choose to limit or take away our ability to borrow these or any funds. Should this occur, or if the credit markets further tighten or our business declines, we may need or choose to raise additional capital to repay indebtedness, pursue acquisitions or expand our operations. Such additional capital may be raised through bank borrowings, or other debt or equity financings. We cannot assure you that any additional capital will be available on a timely basis, on acceptable terms, or at all, and such additional financing may result in further dilution to our stockholders.

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

- market acceptance of our products and product enhancements, and the overall level of sales of our products;
- our ability to control costs;
- the supply of key components for our products;
- our ability to increase revenue and net income;
- increased research and development expenses and sales and marketing expenses;
- our need to respond to technological advancements and our competitors' introductions of new products or technologies;
- capital improvements to new and existing facilities and enhancements to our infrastructure and systems;
- potential acquisitions of businesses and product lines;



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- our relationships with customers and suppliers;
- government budgets, political agendas and other funding issues, including potential delays in government contract awards;
- our ability to successfully negotiate credit arrangements with our bank and the state of the financial markets, in general; and
- general economic conditions, including the effects of the current economic slowdown and international conflicts.

If our capital requirements are materially different from those currently planned, we may need additional capital sooner than anticipated. If additional funds are raised through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders will be reduced and such securities may have rights, preferences and privileges senior to our common stock. Additional equity or debt financing may not be available on favorable terms, on a timely basis, or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to continue our operations as planned, develop or enhance our products, expand our sales and marketing programs, take advantage of future opportunities or respond to competitive pressures.

**The trading price of our common stock is highly volatile.** The trading price of our common stock has been subject to wide fluctuations in the past. Since April 2010, our common stock has traded at prices as low as \$0.90 per share and as high as \$2.25 per share. The market price of our common stock could continue to fluctuate in the future in response to various factors, including, but not limited to:

- quarterly variations in operating results;
- our ability to control costs, improve cash flow and sustain profitability;
- our ability to raise additional capital;
- shortages announced by suppliers;
- announcements of technological innovations or new products or applications by our competitors, customers or us;



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- transitions to new products or product enhancements;
  
- acquisitions of businesses, products or technologies;
  
- the impact of any litigation;
  
- changes in investor perceptions;
  
- government funding, political agendas and other budgetary constraints;
  
- changes in earnings estimates or investment recommendations by securities analysts; and
  
- international conflicts, political unrest and acts of terrorism.

The stock market in general has from time to time experienced volatility, which has often affected the market prices of equity securities of many technology companies. This volatility has often been unrelated to the operating performance of these companies. These broad market fluctuations may adversely affect the market price of our common stock. In the past, companies that have experienced volatility in the market price of their securities have been the subject of securities class action litigation. If we were to become the subject of a class action lawsuit, it could result in substantial losses and divert management's attention and resources from other matters.

**Certain provisions of our charter documents may discourage a third party from acquiring us and may adversely affect the price of our common stock.** Certain provisions of our certificate of incorporation could make it difficult for a third party to acquire us, even though an acquisition might be beneficial to our stockholders. Such provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. Under the terms of our certificate of incorporation, our Board of Directors is authorized to issue, without stockholder approval, up to 2,000,000 shares of preferred stock with voting, conversion and other rights and preferences superior to those of our common stock. In August 2009, we adopted a new stockholder rights plan and declared a dividend of preferred stock purchase rights to our stockholders. Generally, the stockholder rights plan provides that if a person or group acquires 15% or more of our common stock, subject to certain exceptions and under certain circumstances, the rights may be exchanged by us for common stock or the holders of the rights, other than the acquiring person or group, could acquire additional shares of our capital stock at a discount off of the then current market price. Such exchanges or exercise of rights could cause substantial dilution to a particular acquirer and discourage the acquirer from pursuing our company. The mere existence of a stockholder rights plan often delays or makes a merger, tender offer or other acquisition more difficult.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our headquarters and principal operations are housed in approximately 52,000 square feet of leased office, manufacturing and warehouse space located in Santa Ana, California. This facility lease expires in 2015 and contains an option to extend the lease for an additional five years at the market rate at that time. For additional information regarding our obligations under property leases, see Note 9 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report.

**ITEM 3. LEGAL PROCEEDINGS**

The information set forth under the heading **Litigation and Other Contingencies** under Note 9 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report, is incorporated herein by reference.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information and Holders**

Our common stock is traded on the NYSE MKT under the symbol ITI. The following table sets forth, for the periods indicated, the highest and lowest sales prices for our common stock as reported by NYSE MKT:

		<b>High</b>		<b>Low</b>
<b>Fiscal 2013</b>				
Quarter Ended June 30, 2012	\$	1.52	\$	1.25
Quarter Ended September 30, 2012		1.72		1.34
Quarter Ended December 31, 2012		1.82		1.45
Quarter Ended March 31, 2013		1.91		1.55
<b>Fiscal 2012</b>				
Quarter Ended June 30, 2011	\$	1.58	\$	1.22
Quarter Ended September 30, 2011		1.35		0.90
Quarter Ended December 31, 2011		1.39		1.08
Quarter Ended March 31, 2012		1.58		1.31

On May 28, 2013, the last reported sales price of our common stock on the NYSE MKT was \$1.70. As of May 28, 2013, we had 402 holders of record of our common stock according to information furnished by our transfer agent.

**Dividend Policy**

We have never paid or declared cash dividends on our common stock, and have no current plans to pay such dividends in the foreseeable future. We currently intend to retain any earnings for working capital and general corporate purposes. The payment of any future dividends will be at the discretion of our Board of Directors and will depend upon a number of factors, including, but not limited to, future earnings, the success of our business, our capital requirements, our general financial condition and future prospects, general business conditions, the consent of our lender and such other factors as the Board of Directors may deem relevant.

**Issuer Purchases of Equity Securities**

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In August 2011, our Board of Directors approved a stock repurchase program pursuant to which we were authorized to acquire up to \$3 million of our outstanding common stock from time to time through August 2012. On August 9, 2012, our Board of Directors approved a new stock repurchase program pursuant to which we may acquire up to \$3 million of our outstanding common stock for an unspecified length of time. Under the new program, we may repurchase shares from time to time in open-market and privately negotiated transactions and block trades, and may also repurchase shares pursuant to an existing or future 10b5-1 trading plan to facilitate repurchases during our closed trading windows. There is no guarantee as to the exact number of shares that will be repurchased. We may modify or terminate the repurchase program at any time without prior notice. The table below details our common stock repurchases during the fourth quarter of Fiscal 2013. All repurchased shares have been retired and resumed their status as authorized and unissued shares of our common stock.

Table of Contents**Issuer Purchases of Equity Securities**

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs</b>
Jan 1 to Jan 31, 2013	109,908	\$ 1.68	109,908	
Feb 1 to Feb 28, 2013	286,804	1.66	286,804	
Mar 1 to Mar 31, 2013	267,338	1.75	267,338	
<b>Total</b>	<b>664,050</b>	<b>\$ 1.70</b>	<b>664,050</b>	<b>\$ 1,086,000</b>

**ITEM 6. SELECTED FINANCIAL DATA**

As a smaller reporting company, we are not required to make any disclosure pursuant to this Item 6.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis in conjunction with our Consolidated Financial Statements and related Notes thereto included in Part IV, Item 15 of this report and the Risk Factors section in Item 1A, as well as other cautionary statements and risks described elsewhere in this report, before deciding to purchase, hold or sell our common stock.*

**Overview**

**General.** 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. By combining our unique intellectual property, products, decades of experience in traffic management and information technologies, we offer a broad range of Intelligent Transportation Systems ( ITS ) solutions to customers worldwide.

**Acquisitions.** In November 2011, we acquired all of the outstanding capital stock of Berkeley Transportation Systems, Inc. ( BTS ), a privately-held company based in Berkeley, California which specializes in transportation performance measurement, for an initial cash payment of approximately \$840,000. In the quarter ended December 31, 2012, the Company entered into an amendment to the BTS stock purchase agreement which modified certain earn-out provisions and as a result, the Company paid \$700,000 in cash to the BTS shareholders for

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achievement of those modified earn-out provisions in the fourth quarter of Fiscal 2013. The amendment did not have a material impact on previous estimated amounts accrued in connection with the earn-out provisions. This payment completed the Company's obligation under the earn-out provisions of the agreement. Additionally, we are scheduled to pay to the BTS shareholders up to a total of approximately \$585,000 by November 2014 pursuant to certain holdback and deferred payment provisions.

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. MET specializes in 511 advanced traveler information systems and offers Maintenance Decision Support System ( MDSS ) management tools that allow users to create solutions to meet roadway maintenance decision needs. We also agreed to pay up to \$1 million on each of the first two anniversaries of the closing of the acquisition upon the satisfaction of certain conditions, as well as up to an additional \$2 million under a 24-month earn-out provision.

In January 2012, we made a cash payment of approximately \$668,000 of the first deferred payment to the shareholders of MET and held back \$250,000 in accordance with certain provisions of the purchase agreement. In June 2012, we determined the contingencies related to the release of the \$250,000 holdback were not met. As a result, no portion of the \$250,000 holdback was released and the entire amount was reversed into operating income during the second quarter of Fiscal 2013. Additionally, no amounts were earned by the MET shareholders related to the first and second year earn-out provisions, which ended on December 31, 2011 and 2012, respectively. The second deferred payment of \$1 million was due in the fourth quarter of Fiscal 2013. As a result of certain holdback provisions and other deductions, we currently expect to pay approximately \$400,000 to the MET shareholders in the first quarter of the Fiscal 2014, which is recorded in our accrued liabilities in our consolidated balance sheet at March 31, 2013.



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Refer to Note 4 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report, for additional discussion on these acquisitions.

**Sale of Vehicle Sensors.** On July 29, 2011, we completed the sale of substantially all of our assets used in connection with our Vehicle Sensors segment to Bendix 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 of March 31, 2013, we received approximately \$0.9 million in connection with royalty-related earn-outs provisions for a total of \$14.6 million in cash from the Asset Sale. 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. 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. Refer to Note 3 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report, for additional discussion on this transaction.

**Business Segments.** Subsequent to the Asset Sale and our acquisition of BTS, we now operate in three reportable segments: Roadway Sensors, Transportation Systems and iPerform.

*Roadway Sensors*

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.

*Transportation Systems*

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 weather related Maintenance Decision Support System management tools that allow users to create solutions to meet roadway maintenance decision needs.

*iPerform*

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.

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Beginning in April 2013, we internally recognized certain groups within our Transportation Systems and iPerform segments to better align our resources and deliverables with the activities of those segments. As a result, all of the revenues and expenses of the predictive weather and Maintenance Decision Support System operations include in Transportation Systems will be reassigned to iPerform.

**Business.** Given the current ongoing uncertainties regarding global economic conditions, we continue to remain cautious about our overall business. We believe the overall ongoing unfavorable economic environment has negatively affected, and may continue to negatively affect, our financial results for the foreseeable future, and may impair our ability to accurately forecast our future financial performance and other business trends. In addition, since the end users of a majority of our products and services are governmental entities, we have been, and may continue to be, negatively affected by the budgetary issues and delays in purchasing decisions that many municipalities and other state and local agencies continue to face. Spending for new roadways, new systems to address traffic congestion and other transportation infrastructure improvements has been delayed or eliminated in some instances. However, we believe the need to rebuild and modernize aging transportation infrastructure will continue, and in addition to funds available through the federal highway bill, there exist various other funding mechanisms that support transportation infrastructure and related projects. These include bonds, dedicated sales and gas tax measures and other alternative funding sources.

### **Critical Accounting Policies and Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our consolidated financial statements included herein, which have been prepared in accordance with accounting principles generally accepted in the

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United States ( GAAP ). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate these estimates and assumptions, including those related to the collectability 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, the valuation of contingent acquisition consideration, 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 following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

**Revenue Recognition.** 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 under the terms of the arrangement 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 relative 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.

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 elements and is recognized as revenue.

Transportation Systems revenues are derived primarily from long-term contracts with governmental agencies. When appropriate, revenues are recognized using the percentage of completion method of accounting, whereby revenue is recognized as contract performance progresses and is 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

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incentives are included in revenues when their realization is reasonably assured. Certain of our revenues are recognized as services are performed and amounts are earned, which is measured by time incurred or other contractual milestones or output measures. Revenues accounted for in this manner generally relate to certain cost-plus fixed fee or time-and-materials contracts.

***Accounts Receivable.*** The collectability of our accounts receivable is evaluated through review of outstanding invoices and ongoing credit evaluations of our customers' financial condition. We record an allowance for doubtful accounts for specific receivables deemed to be at risk for collection as well as a general allowance based on our historical collections experience. Considerable judgment is required in assessing and estimating the ultimate realization of trade receivables, including the current credit-worthiness of each customer. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make required payments, additional allowances may be required that could adversely affect our operating results.

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**Inventories.** Inventories consist of finished goods, work-in-process and raw materials and are stated at the lower of cost or market. We write down the carrying value of our inventories to net realizable value for estimated excess and obsolete inventories in an amount equal to the difference between the cost of the inventories and their estimated realizable value. These estimates are based on management's judgments and assumptions as to future demand requirements and our evaluation of market conditions. Demand for our products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than those projected by management. In the event that actual demand is lower than originally projected, additional inventory write-downs may be required. Estimated inventory write-downs, once established, are not reversed until the related inventory has been sold or scrapped, so if actual market conditions are more favorable in the fiscal periods subsequent to those in which we record significant write-downs, we may have higher gross margins when products are sold.

**Goodwill and Other Long-Lived Assets.** Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the acquired net tangible and intangible assets. Other long-lived assets primarily represent purchased intangible assets including developed technology, customer relationships, trade names and patents. We currently amortize our intangible assets with definitive lives over periods ranging from one to seven years using a method that reflects the pattern in which the economic benefits of the intangible asset are consumed or otherwise used or, if that pattern cannot be reliably determined, using a straight-line amortization method over the estimated useful life of the asset.

We evaluate goodwill on an annual basis in our fourth fiscal quarter or more frequently if we believe indicators of impairment exist. We have determined that our reporting units for purposes of testing for goodwill impairment are identical to our reportable segments for financial reporting purposes. In Fiscal 2012, we early adopted the provisions issued by the Financial Accounting Standard Board ( FASB ) that were intended to simplify goodwill impairment testing. This guidance permits us to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, we conduct a two-step goodwill impairment test. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their carrying values. We determine the fair values of our reporting units using the income valuation approach, as well as other generally accepted valuation methodologies. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, we perform the second step of the goodwill impairment test. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill. The amount by which the carrying value of the goodwill exceeds its implied fair value, if any, is recognized as an impairment loss. 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. As part of our annual assessment, management determines the most appropriate and efficient method to assess goodwill for impairment, which could include either the simplified testing approach or the two-step goodwill test described above.

We test long-lived assets and purchased intangible assets (other than goodwill) for impairment if we believe indicators of impairment exist. We determine whether the carrying value of an asset or asset group is recoverable, based on comparisons to undiscounted expected future cash flows the asset are expected to generate. If an asset is not recoverable, we record an impairment loss equal to the amount by which the carrying value of the asset exceeds its fair value. We primarily use the income valuation approach to determine the fair value of our long lived assets and purchased intangible assets.

**Warranty.** We generally provide a one to three year warranty from the original invoice date on our products, materials and workmanship. Products sold to various original equipment manufacturer 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 consolidated balance sheets. Should our actual experience of warranty returns be higher than anticipated, additional warranty reserves may be required, which would adversely affect our product gross profit and our operating results.

**Income Taxes.** We utilize the asset and liability method of accounting for income taxes, under which deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more-likely-than-not that some or all of the deferred tax assets will not be realized, which increases our income tax expense in the period such determination is made.

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 this anticipated rate. As the fiscal year progresses, we refine our estimates based upon actual events and financial results during the year. This estimation 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.

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Income tax positions must meet a more-likely-than-not recognition threshold to be recognized. Income tax positions that previously failed to meet the more-likely-than-not threshold are recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations and court rulings. Therefore, the actual liability for U.S. or foreign taxes may be materially different from our estimates, which could result in the need to record additional tax liabilities or potentially reverse previously recorded tax liabilities.

**Stock-Based Compensation.** We record stock-based compensation in the statements of operations as an expense, based on the estimated grant date fair value of our stock-based awards, whereby such fair values are amortized over the requisite service period. Our stock-based awards are currently comprised of common stock options and restricted stock units. The fair value of our stock option awards is estimated on the grant date using the Black-Scholes-Merton ( BSM ) option-pricing formula. While utilizing this model meets established requirements, the estimated fair values generated by it may not be indicative of the actual fair values of our stock option awards as it does not consider certain factors important to those awards to employees, such as continued employment and periodic vesting requirements as well as limited transferability. The fair value of our restricted stock units is based on the closing market price of our common stock on the grant date. If there are any modifications or cancellations of the underlying unvested stock-based awards, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense.

**Recent Accounting Pronouncements**

Refer to Note 1 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report, for a discussion of recent accounting pronouncements.

**Results of Operations**

The following table sets forth certain statement of operations data as a percentage of revenues for the periods indicated.

	2013	Year Ended March 31, 2012	2011
Total revenues	100.0%	100.0%	100.0%
Cost of revenues	62.3	60.5	56.0
Gross profit	37.7%	39.5%	44.0%
Operating expenses:			
Selling, general and administrative	29.3	30.8	32.7
Research and development	5.0	5.4	4.7
Amortization of intangible assets	1.0	0.9	0.3

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Change in fair value of contingent consideration	(0.3)	(1.1)	0.1
Impairment of goodwill			15.3
Total operating expenses	35.1	36.0	53.1
Operating income (loss)	2.6	3.5	(9.1)
Non-operating income (expense):			
Other income, net	0.0	0.0	0.0
Interest expense, net	(0.0)	(0.1)	(0.3)
Income (loss) from continuing operations before income taxes	2.6	3.4	(9.4)
Provision for income taxes	(1.2)	(1.1)	(0.5)
Income (loss) from continuing operations	1.5	2.3	(9.9)
Gain on sale of discontinued operation, net of tax	2.4	2.0	
Income (loss) from discontinued operation, net of tax		0.0	(0.1)
Net income (loss)	3.9%	4.3%	(10.0)%



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**Total Revenues.** Total revenues are comprised of sales from our Roadway Sensors, Transportation Systems and iPerform segments.

The following tables present details of total revenues for Fiscal 2013 compared to Fiscal 2012, and Fiscal 2012 compared to Fiscal 2011:

	Year Ended March 31,		Increase		%
	2013	2012	(In thousands, except percentages)		Change
Total revenues	\$ 61,685	\$ 58,406	\$ 3,279		5.6%

	Year Ended March 31,		Increase		%
	2012	2011	(in thousands, except percentages)		Change
Total revenues	\$ 58,406	\$ 51,966	\$ 6,440		12.4%

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 Fiscal 2011, no individual customer represented greater than 10% of our total revenues.

Total revenues for Fiscal 2013 increased approximately 6% to \$61.7 million, compared to \$58.4 million in Fiscal 2012, due primarily to an increase of approximately 9% in Transportation Systems revenues and an increase in iPerform revenues of approximately \$2.4 million, which was attributable to a full twelve months of revenues in Fiscal 2013 from the acquisition of BTS in November 2011. These increases in revenue were partially offset by an approximate 6% decrease in Roadway Sensors revenues.

Total revenues for Fiscal 2012 increased approximately 12% to \$58.4 million, compared to \$52.0 million in Fiscal 2011, due primarily to an increase of approximately 25% in Transportation Systems revenues, partially offset by a decrease of approximately 2% in Roadway Sensors revenues. Approximately \$3.1 million of the increase in total revenues was attributable to a full year of MET revenues, while \$935,000 of the increase was attributable to the acquisition of BTS in November 2011.

Roadway Sensors revenues in Fiscal 2013 decreased approximately 6% compared to Fiscal 2012, due mainly as a result of a decrease in federal stimulus funded projects and as a result of the discontinuation of redevelopment agencies in California. The federal stimulus funded projects and redevelopment agencies in California had a positive impact on Roadway Sensors revenues in the prior year periods. Roadway Sensors revenues in Fiscal 2012 were marginally lower compared to Fiscal 2011 due primarily to certain international customer orders in Fiscal 2011 which did not recur in Fiscal 2012. Going forward, we plan to focus on our core domestic intersection market and refine and deliver products that address the needs of this market, namely our Vantage processor and camera systems and our Vantage Vector video/radar hybrid sensor, as well as our SmartCycle and SmartScan products, which were introduced in Fiscal 2013. We also plan to focus on international distribution channel expansion and expect to continue to refine products that address these markets, namely our Abacus, Pico and VersiCam products.

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Revenues from our Transportation Systems segment are primarily dependent upon the continued availability of funding at the local, state and federal levels from the various agencies and departments of transportation. Transportation Systems revenues for Fiscal 2013 increased approximately 9% compared to Fiscal 2012 due in part to several significant project wins in the first two quarters of Fiscal 2013. Transportation Systems revenues for Fiscal 2012 increased approximately 25% compared to Fiscal 2011, primarily due to several significant project wins in the last two quarters of Fiscal 2012, as well as a full year of MET revenues, which increased by \$3.1 million from Fiscal 2011. 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 Transportation Systems 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 upon government funding initiatives in the markets we serve.

Approximately \$3.3 million of the total revenues in Fiscal 2013 and approximately \$935,000 of the total revenues in Fiscal 2012 were attributable to the iPerform segment and was a direct result of the BTS acquisition in November 2011. Going forward, we

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plan to continue investing in this segment, particularly in research, development, sales and marketing of the IterisPeMS performance measurement solutions with a near-term focus on delivering IterisPeMS to public agencies. We also plan for iPerform to pursue commercial opportunities in the media and automotive sectors, offering both data services and analytics.

The recently enacted federal highway bill could provide government agencies with funding for ITS technologies in transportation infrastructure, traffic management and performance measurement projects.

**Gross Profit.** The following tables present details of our gross profit for Fiscal 2013 compared to Fiscal 2012, and Fiscal 2012 compared to Fiscal 2011:

	Year Ended March 31,		Increase	%
	2013	2012		Change
	(In thousands, except percentages)			
Gross profit	\$ 23,258	\$ 23,071	\$ 187	0.8%
Gross profit as a % of total revenues	37.7%	39.5%		

	Year Ended March 31,		Increase	%
	2012	2011		Change
	(in thousands, except percentages)			
Gross profit	\$ 23,071	\$ 22,884	\$ 187	0.8%
Gross profit as a % of total revenues	39.5%	44.0%		

Our total gross profit as a percentage of total revenues for Fiscal 2013 decreased approximately 1.8% compared to Fiscal 2012 primarily as a result of our product and service mix. Revenues derived from our Roadway Sensors segment decreased to approximately 42% of our total revenues in Fiscal 2013 as compared to 47% in Fiscal 2012. Roadway Sensors revenues generally carry higher margins than Transportation Systems and iPerform revenues; therefore, a shift in the sales mix weighted less towards Roadway Sensors revenues can negatively impact our overall margin. Gross profits as a percentage of total revenues also declined, to a lesser extent, as a result of an approximate 2.7% decrease in Roadway Sensors profit margins due to the overall decrease in revenues and an increase in sustaining engineering activities.

Our total gross profit as a percentage of total revenues decreased in Fiscal 2012 compared to Fiscal 2011 primarily as a result of our product and service mix, whereby Transportation Systems revenues significantly increased as percentage of total revenues. Roadway Sensors revenues represented approximately 47% of our total revenues in Fiscal 2012 compared to 54% in Fiscal 2011. The decrease in gross profit percentage was also attributable the Roadway Sensors customer mix between dealer sales and direct sales, whereby we generally enjoy higher gross margins on direct product sales as compared to sales through our dealer channels. The decrease was also due in part to certain manufacturing overhead costs previously absorbed by the Vehicle Sensors segment that was divested in Fiscal 2011.

Roadway Sensors gross profit 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

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development activities to sustaining activities, which we record as cost of goods sold.

We recognize a portion of our Transportation Systems 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. For the Transportation Systems segment, we expect to experience gross profit variability in future periods due to our contract mix and related sub-consulting content, as well as factors such as paid holidays and our ability to efficiently utilize our workforce, which could or may cause fluctuations in our margins from period to period. If sub-consultant content further expands as a percentage of our overall Transportation System revenues, we may experience a flat or declining gross profit percentage in this segment.

### *Selling, General and Administrative Expense*

The following table presents selling, general and administrative expense for Fiscal 2013 and Fiscal 2012:

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Salary and personnel-related	\$	12,223	19.8%	\$	12,434	21.3%	\$	(211)	(1.7)%
Travel and conferences		1,281	2.1		1,568	2.7		(287)	(18.3)
Other		367	0.6		353	0.6		14	4.0

Selling, general and administrative expenses for Fiscal 2013 were generally consistent, in total, with those in Fiscal 2012. The increase in facilities and insurance costs was due to the increase cost of rent, rent related expenses and insurance coverage for a full twelve month period for our Berkeley, California office, related to the operations of BTS that were acquired in November 2011. This increase was partially offset by a decrease in travel expenses, as well a decrease in general salary and personnel-related expenses.

The following table presents selling, general and administrative expense for Fiscal 2012 and 2011:

Salary and personnel-related	\$	12,434	21.3%	\$	11,952	23.0%	\$	482	4.0%
Travel and conferences		1,568	2.7		1,205	2.3		363	30.1
Other		353	0.6		295	0.6		58	19.7

The increase in selling, general and administrative expenses in Fiscal 2012 as compared to Fiscal 2011 was primarily due to (i) higher salary, travel and headcount-related expenses as we added certain key sales and marketing personnel, (ii) added personnel as well as facilities and other related operating costs as a result of the MET and BTS acquisitions, (iii) certain legal and professional services related to the sale of our Vehicle Sensors segment that were not offset against the gain on the Asset Sale and (iv) certain other corporate initiatives related to the development of our performance measurement software.

***Research and Development Expense***

The following table presents research and development expense for Fiscal 2013 and Fiscal 2012:

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	Year Ended March 31,		2012		Increase (Decrease)	% Change
	2013	% of	Amount	% of		
	Amount	Revenues	Amount	Revenues		
	(In thousands, except percentages)					
Salary and personnel-related	\$ 1,454	2.4%	\$ 2,153	3.7%	\$ (699)	(32.5)%
Facilities, development and supplies	1,378	2.2	792	1.3	586	74.0
Other	239	0.4	238	0.4	1	0.4
Research and development	\$ 3,071	5.0%	\$ 3,183	5.4%	\$ (112)	(3.5)

Research and development expense in Fiscal 2013 decreased approximately 4% when compared to Fiscal 2012, primarily due to certain expenditures related to software development in the iPeform segment that in the current year periods have been capitalized to the balance sheet as well as certain reductions to Roadway Sensors salary and personnel-related expenditures. These reductions were offset by an increase in facility rents, development and supplies expense. The increase in facility costs was

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attributable to a full twelve month period for our Berkeley, California office, related to the operations of BTS that were acquired in November 2011.

The following table presents research and development expense for Fiscal 2012 and Fiscal 2011:

	Year Ended March 31,		2011		Increase	% Change
	2012	% of Revenues	Amount	% of Revenues		
	Amount		Amount			
	(In thousands, except percentages)					
Salary and personnel-related	\$ 2,153	3.7%	\$ 1,736	3.3%	\$ 417	24.0%
Facilities, development and supplies	792	1.3	557	1.1	235	42.2
Other	238	0.4	151	0.3	87	57.6
Research and development	\$ 3,183	5.4%	\$ 2,444	4.7%	\$ 739	30.2

Research and development expenses for Fiscal 2012 were higher than Fiscal 2011 primarily due to (i) the allocation of additional resources to various development projects in our Roadway Sensors segment, including our Vantage Vector vehicle detection sensor, (ii) development costs related to our IterisPeMS information management solution, and (iii) additional headcount and other expenses in Fiscal 2012 related to the MET and BTS acquisitions.

### *Impairment of Goodwill*

In Fiscal 2012, we adopted the provisions issued by the FASB that are intended to simplify goodwill impairment testing. The updated guidance permits us to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, we conduct a two-step goodwill impairment test. We performed annual impairment assessments of the carrying value of goodwill for Fiscal 2013 and Fiscal 2012 in their fourth fiscal quarters, respectively. We determined it was more appropriate and cost effective to perform a qualitative assessment in Fiscal 2012 and a quantitative first-step assessment in Fiscal 2013 to estimate the fair value of our reporting units using the income approach. Based on our assessments, we determined that no impairment was indicated as the estimated fair value of each reporting unit exceeded its respective carrying value.

During Fiscal 2011, due primarily to lower than expected operating results in our Transportation Systems reporting unit, as well as ongoing weakness specifically in the Transportation Systems markets, we determined it was necessary to perform an interim test of impairment of the carrying value of goodwill in our Transportation Systems reporting unit as of December 31, 2010. In performing the first step in this analysis, we estimated the fair value of our Transportation Systems reporting unit using the income approach. As of December 31, 2010, we determined that the carrying value of our Transportation Systems reporting unit exceeded its estimated fair value and, accordingly, we performed the second step of the impairment analysis to estimate the implied fair value of the goodwill of this reporting unit.

The implied fair value of goodwill was determined in the same manner utilized to estimate the amount of goodwill recognized in a business combination. To determine this value, we estimated the fair value of the assets and liabilities, including certain intangible assets, to be allocated

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to the Transportation Systems reporting unit as of December 31, 2010. The implied fair value of goodwill was measured as the difference between the estimated fair value of the reporting unit over the estimated fair value amounts of its assets and liabilities. The impairment loss for the Transportation Systems reporting unit was measured by the amount the carrying value of its goodwill exceeded the implied fair value of the goodwill. Accordingly, in order to write down Transportation Systems goodwill with a carrying value of \$14.9 million to its implied fair value of \$6.9 million, we recorded an impairment charge of \$8.0 million in the three months ended December 31, 2010, the third quarter of Fiscal 2011.

As a result of the impairment charge taken in Fiscal 2011 and based on our goodwill impairment testing for Fiscal 2012 and Fiscal 2013, we believe the carrying value of our goodwill is not currently at risk of impairment, as the estimated fair values of our reporting units exceeded their carrying values at March 31, 2013. If our actual financial results, or the plans and estimates used in future goodwill impairment analyses, are lower than the original estimates used to assess impairment of our goodwill, we could incur future goodwill impairment charges.

### *Interest Expense, Net*

Net interest expense was approximately \$6,000, \$72,000 and \$152,000 in Fiscal 2013, Fiscal 2012 and Fiscal 2011, respectively. The sequential decreases were primarily due to a continuous decrease in the overall level of borrowings on our term note.



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During the first quarter of Fiscal 2013, all principal and interest payments under the term note were paid in full. See [Liquidity and Capital Resources](#) below for additional details on our borrowings.

### *Income Taxes*

The following table presents our provision for income taxes for Fiscal 2013, Fiscal 2012 and Fiscal 2011:

	2013	Year Ended March 31, 2012		2011		
		(In thousands, except percentages)				
Provision for income taxes	\$	716	\$	643	\$	278
Effective tax rate		43.9%		33.0%		(5.7)%

Our effective tax rate for Fiscal 2013 was unfavorably impacted by permanent non-deductible tax items, including share-based payments and other permanent differences amounting to approximately \$82,000, and by the recording a valuation allowance against certain of our state net operating losses in the amount of \$188,000, net of federal benefit. These unfavorable impacts were partially offset by the recognition of tax credits of approximately \$122,000 for research and development and hiring activities, and by approximately \$62,000 of tax benefit from non-taxable favorable fair value adjustments recognized for financial statement purposes.

Our effective tax rate for Fiscal 2012 was favorably impacted by the recognition of approximately \$276,000 of previously unrecognized tax benefits during the year due to the expiration of statutes limitation in various jurisdictions, by the recognition of tax credits of approximately \$246,000 for research and development activities, and by approximately \$211,000 of tax benefit from non-taxable favorable fair value adjustments recognized for financial statement purposes. These favorable impacts were partially offset by the impact of recognizing approximately \$466,000 of expense upon the expiration of a state net operating loss, net of federal benefit. Our effective tax rate for Fiscal 2011 was impacted unfavorably by a portion of the charge recorded for the impairment of goodwill, amounting to approximately \$2.2 million, for which there is no corresponding tax basis. This unfavorable impact was partially offset by the impact of the recognition of approximately \$327,000 of previously unrecognized tax benefits during the year due to expiration of certain federal and state statutes in various jurisdictions.

As of March 31, 2013, we recorded a valuation allowance against certain of our state net operating loss carryforwards in the amount of \$188,000, net of federal tax benefit, which we estimated were more likely to not be realized within the applicable carryforward period. As of March 31, 2012, we determined that it was more likely than not that our deferred tax assets would be realized and no general valuation allowance was recorded against our deferred tax assets at that time.

As we update our estimates in future periods, adjustments to our deferred tax asset and valuation allowance may be necessary. We anticipate this will cause our future overall effective tax rate in any given period to fluctuate from prior effective tax rates and statutory tax rates. We utilize the liability method of accounting for income taxes. We record net deferred tax assets to the extent that we believe these assets will more likely than not be realized. In making such determination, we consider all available positive and negative evidence, including, but not limited to, scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial performance.

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At March 31, 2013, we had \$22.0 million of federal net operating loss carryforwards and \$9.2 million of state net operating loss carryforwards that begin to expire in 2021 and 2014, respectively. Although the impact cannot be precisely determined at this time, we believe that our net operating loss carryforwards will cause us to have future income tax payments that are substantially lower than the income tax liability calculated using statutory tax rates. Due to changes in stock ownership, our federal net operating loss carryforwards and other federal attributes are subject to a Section 382 annual limitation. As of March 31, 2013, based on the cumulative amount of tax attributes that have become available under the limitation imposed by Section 382, all of our net operating losses are currently fully available for use.

### **Liquidity and Capital Resources**

#### *Cash Flows*

We have historically financed our operations with a combination of cash flows from operations, borrowings under credit facilities and the sale of equity securities. We currently rely on cash flows from operations, or cash position and the availability of borrowings on a line of credit facility to fund our operations, which we believe to be sufficient to fund our operations for at least the next twelve months. However, we may need or choose to raise additional capital to fund potential future acquisitions and our future growth. We may raise such funds by selling equity or debt securities to the public or to selected investors or by borrowing money from

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financial institutions. If we raise additional funds by issuing equity or convertible debt securities, our existing stockholders may experience significant dilution and any equity securities that may be issued may have rights senior to our existing stockholders.

At March 31, 2013, we had \$29.4 million in working capital, which included no borrowings on our \$12.0 million line of credit and \$19.1 million in cash and cash equivalents. This compares to working capital of \$28.4 million at March 31, 2012, which included no borrowings on our line of credit and \$18.7 million in cash and cash equivalents.

The following table summarizes our cash flows for Fiscal 2013, Fiscal 2012 and Fiscal 2011:

	Year Ended March 31,		
	2013	2012	2011
	(In thousands)		
<b>Net cash provided by (used in):</b>			
Operating activities	\$ 3,652	\$ 668	\$ 5,346
Investing activities	367	10,002	(1,530)
Financing activities	(3,583)	(3,787)	(2,403)

**Operating Activities.** Cash provided by our operations in Fiscal 2013 was the result of (i) adding back to net income \$901,000 of depreciation expense, \$279,000 of stock-based compensation expense, \$644,000 of amortization expense and \$1.4 million of deferred tax assets, (ii) deducting from net income \$181,000 in changes in the fair value of contingent consideration related to our prior acquisitions of MET and BTS and \$1.5 million of gain on the sale of Vehicle Sensors and (iii) approximately \$300,000 in negative cash flows resulting from changes in our operating assets and liabilities during Fiscal 2013, all of which was offset by our net income of \$2.4 million for such fiscal year.

Our accounts receivable and net costs and estimated earnings in excess of billings increased approximately \$851,000, or 5%, during Fiscal 2013 mainly as a result of an approximate 6% year-over-year increase in revenues. In the future, our accounts receivable and net costs and estimated earnings in excess of billings accounts are likely to be determined based upon, among other factors, increases or decreases in revenues, the timing of collections of existing receivables and our ability to timely invoice our billings in excess of costs. We try to offset significant increases in accounts receivables through increased and focused collection efforts; however, we cannot assure you that our efforts will be successful.

The increase in accounts payable by approximately \$1.4 million at March 31, 2013 compared to March 31, 2012 was largely driven by the general timing of payments to vendors and sub-consultants.

Cash provided by our operations in Fiscal 2012 was the result of (i) adding back to net income \$907,000 of depreciation expense, \$331,000 of stock-based compensation expense, \$504,000 of amortization expense and \$286,000 of deferred tax assets, (ii) deducting from net income \$619,000 in changes in the fair value of contingent consideration related to our acquisitions of MET and BTS and \$1.2 million for the gain on sale of Vehicle Sensors and (iii) \$2.1 million in negative cash flows resulting from changes in our operating assets and liabilities during Fiscal 2012, all of which was offset by our net income of \$2.5 million for such fiscal year.

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Our accounts receivable and net costs and estimated earnings in excess of billings increased approximately \$3.0 million, or 22%, during Fiscal 2012 mainly as a result of a 12% year-over-year increase in net sales and contract revenues as well as the timing of collection on certain receivables.

Cash provided by our operations in Fiscal 2011 was the result of (i) \$9.9 million in non-cash items within the statement of operations, primarily consisting of \$8.0 million for the impairment of goodwill, depreciation expense of \$1.0 million and stock-based compensation expense of \$382,000; and (ii) \$614,000 in positive cash flows resulting from changes in our operating assets and liabilities during Fiscal 2011, all of which was offset by our net loss of \$5.2 million for such fiscal year.

Our inventories increased approximately \$953,000, or 35%, during Fiscal 2011 as we built up certain inventories on hand in Fiscal 2011 to meet anticipated increases in our product net sales in our the Roadway Sensors segment. In the future, our inventory levels are likely to continue to be determined based upon, among other factors, the level of purchase orders we receive from our customers, the stage at which our products are in their respective product life cycles, and competitive situations in the marketplace. We attempt to balance such considerations against risk of obsolescence and potentially excess inventory levels.

The increase in accounts payable by approximately \$920,000 from March 31, 2010 to March 31, 2011 was primarily driven by our increased inventory levels and the general timing of payments to vendors.

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**Investing Activities.** Cash provided by our investing activities for Fiscal 2013 consisted of (i) \$1.4 million in proceeds from the sale of the Vehicle Sensors segment, (ii) purchases of property and equipment of \$815,000 and (iii) capitalized software of \$190,000 related to IterisPeMS. Cash provided by our investing activities for Fiscal 2012 consisted of (i) \$11.4 million in proceeds from the sale of the Vehicle Sensors segment, (ii) \$1.0 million used for the acquisition of MET and BTS, which consisted of \$840,000 for the initial purchase of BTS and \$129,000 related to purchase price adjustments for the purchase of MET, (iii) purchases of property and equipment of \$337,000 and (iv) capitalized software of \$138,000 related to IterisPeMS. Cash used in our investing activities for Fiscal 2011 consisted of \$1.1 million used for the acquisition of MET and purchases of property and equipment of \$414,000. For further information on our acquisitions, refer to Note 4 of Notes to Consolidated Financial Statements included in Part IV, Item 15 of this report.

**Financing Activities.** Net cash used in our financing activities during Fiscal 2013 primarily consisted of \$2.5 million used to repurchase our common stock under our stock repurchase program announced in August 2011, \$634,000 in payments on our long-term debt and \$700,000 paid to the BTS shareholders for achievement of earn-out provisions of the purchase agreement. Net cash used in our financing activities during Fiscal 2012 primarily consisted of \$2.3 million in payments on our long-term debt, which consists of a bank term note, \$676,000 related to the first year deferred payment to MET, \$112,000 for the second anniversary payment for a prior acquisition and \$754,000 used to repurchase our common stock under our stock repurchase program. Net cash used in our financing activities during Fiscal 2011 primarily consisted of \$2.4 million in payments on our term note and \$106,000 for the first anniversary payment for a prior acquisition.

**Borrowings**

In October 2008, we entered into a \$19.5 million credit facility with California Bank & Trust ( CB&T ). This credit facility provided for a two-year revolving line of credit with borrowings of up to \$12.0 million and a \$7.5 million 48-month term note. In September 2010, we entered into a modification agreement with CB&T to extend the expiration date of our revolving line of credit to October 1, 2012. In September 2012, we entered into a second modification agreement with CB&T to extend the expiration date of our revolving line of credit to October 1, 2014. 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 March 31, 2013) up to the current stated prime rate plus 0.25%, 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 early termination fees and is secured by substantially all of our assets. As of March 31, 2013 and March 31, 2012, no amounts were borrowed under the revolving line of credit portion of the credit 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.

As of March 31, 2012, we had outstanding borrowings of approximately \$634,000 under the term note, which was set to expire on May 1, 2013. Principal payments under this term note were required to be repaid in monthly installments of \$152,000. During the first quarter of Fiscal 2013, all principal and interest payments under the term note were paid in full. The term note contained no early termination fees.

In connection with our credit facility and loan agreement with the Bank, we are also required to comply with certain quarterly financial covenants. These include achieving ratios for working capital and debt service, as well as maintaining a level of profitability, all of which are further defined in the agreement. While we believe we are currently in compliance with all such financial covenants, we cannot assure you that we will not violate one or more covenants in the future. If we were to be in violation of covenants under this agreement, our lender could choose to accelerate payment on all outstanding loan balances and pursue its security interest in our assets. In this event, we cannot assure you that we would be able to quickly obtain equivalent or suitable replacement financing on acceptable terms, on a timely basis, or at all. If we were not able to secure alternative sources of financing, such acceleration would have a material adverse impact on our business and financial condition.

**Off-Balance Sheet Arrangements**

Other than our operating leases, which are further described at Note 9 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this report, we do not believe we have any other material off-balance sheet arrangements at March 31, 2013.

**Seasonality**

We have historically experienced seasonality, particularly with respect to our Roadway Sensors net sales in our third and fourth fiscal quarters due to a reduction in intersection construction and repairs during the winter months due to inclement weather conditions. With the addition of MET in January 2011, we have also experienced seasonality related to certain MDSS services in our first and second fiscal quarters mainly because these services are generally not required spring and summer time periods.

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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Interest Rate Risk**

Our exposure to interest rate risk is limited to our line of credit. Our line of credit bears interest equal to the prevailing prime rate (3.25% at March 31, 2013) plus 0% to 1.0%. We do not believe that a 10% increase in the interest rate on our line of credit would have a material impact on our financial position, operating results or cash flows.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The financial statements and supplementary data required by Regulation S-X are included in Part IV, Item 15 of this report.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

*(a) Evaluation of disclosure controls and procedures.* In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this Annual Report on Form 10-K, management evaluated, with the participation of the our President and Chief Executive Officer and the Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the President and Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the date of such evaluation in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to management, including the Company's President and Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

*(b) Changes in internal control.* There was no change in our internal control over financial reporting that occurred during the fourth quarter of Fiscal 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### **Inherent Limitations on Internal Control**

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of management override or improper acts, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple errors. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to management override, error or improper acts may occur and not be detected. Any resulting misstatement or loss may have an adverse and material effect on our business, financial condition and results of operations.

### **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance to management and our Board of Directors regarding the effectiveness of our internal control processes over the preparation and fair presentation of published financial statements.

We have assessed the effectiveness of our internal controls over financial reporting as of March 31, 2013. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in *Internal Control Integrated Framework*. Based on our assessment, we believe that, as of March 31, 2013, our internal control over financial reporting was effective based on those criteria.



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This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Such a report is not required pursuant to the rules of the SEC applicable to smaller reporting companies.

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

(a) *Identification of Directors.* The information under the caption Election of Directors, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

(b) *Identification of Executive Officers.* The information under the caption Executive Compensation and Other Information - Executive Officers, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

(c) *Compliance with Section 16(a) of the Exchange Act.* The information under the caption Section 16(a) Beneficial Ownership Reporting Compliance, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

(d) *Corporate Governance.* The information under the caption Corporate Governance, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

(e) *Audit Committee.* The information under the caption Board Meetings and Committees Audit Committee, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

**ITEM 11. EXECUTIVE COMPENSATION**

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The information under the caption Executive Compensation and Other Information, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information under the captions Equity Compensation Plans and Principal Stockholders and Common Stock Ownership of Certain Beneficial Owners and Management, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information under the captions Corporate Governance Director Independence and Certain Transactions, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information under the caption Fees Paid to Independent Registered Public Accounting Firm, appearing in our proxy statement for the 2013 Annual Meeting of Stockholders, is incorporated herein by reference.

## **PART IV**

### **ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(a) Documents filed as part of this report:

1. *Financial Statements.* The following financial statements of Iteris, Inc. are included in a separate section of this Annual Report on Form 10-K commencing on the pages referenced below:

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<u>Report of Independent Registered Public Accounting Firm</u>	35
<u>Consolidated Balance Sheets as of March 31, 2013 and 2012</u>	36
<u>Consolidated Statements of Operations for the fiscal years ended March 31, 2013, 2012 and 2011</u>	37
<u>Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the fiscal years ended March 31, 2013, 2012 and 2011</u>	38
<u>Consolidated Statements of Cash Flows for the fiscal years ended March 31, 2013, 2012 and 2011</u>	39
<u>Notes to Consolidated Financial Statements</u>	40

2. *Exhibits.*

The exhibits listed on the accompanying Exhibit Index immediately following the financial statements are filed as part of, or hereby incorporated by reference into, this report.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: June 7, 2013

ITERIS, INC.  
(Registrant)

By /S/ ABBAS MOHADDES  
Abbas Mohaddes  
Chief Executive Officer  
(Principal Executive Officer)

**POWER OF ATTORNEY**

We, the undersigned officers and directors of Iteris, Inc., do hereby constitute and appoint James S. Miele and Abbas Mohaddes, and each of them, our true and lawful attorneys-in-fact and agents, each with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this report, and to file the same, with exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby, ratifying and confirming all that each of said attorneys-in-fact and agents, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated:

Signature	Title	Date
/s/ ABBAS MOHADDES Abbas Mohaddes	Director, President and Chief Executive Officer (principal executive officer)	June 7, 2013
/s/ JAMES S. MIELE James S. Miele	Chief Financial Officer (principal financial and accounting officer)	June 7, 2013
/s/ GREGORY A. MINER Gregory A. Miner	Chairman of the Board	June 7, 2013
/s/ RICHARD CHAR Richard Char	Director	June 7, 2013
/s/ KEVIN C. DALY Kevin C. Daly, Ph.D.	Director	June 7, 2013

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/s/ JOEL SLUTZKY Joel Slutzky	Director	June 7, 2013
/s/ THOMAS L. THOMAS Thomas L. Thomas	Director	June 7, 2013
/s/ MIKEL WILLIAMS Mikel Williams	Director	June 7, 2013

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**Iteris, Inc.**

**Index to Consolidated Financial Statements**

<u>Report of Independent Registered Public Accounting Firm</u>	35
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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders

Iteris, Inc.

We have audited the accompanying consolidated balance sheets of Iteris, Inc. and subsidiaries as of March 31, 2013 and 2012, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Iteris, Inc. and subsidiaries as of March 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

*/s/ McGladrey LLP*  
Irvine, California  
June 7, 2013

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## Iteris, Inc.

## Consolidated Balance Sheets

(In thousands, except par value)

	2013	March 31,	2012
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ 19,137	\$	18,701
Trade accounts receivable, net of allowance for doubtful accounts of \$322 and \$379 at March 31, 2013 and March 31, 2012, respectively	10,946		11,081
Costs in excess of billings on uncompleted contracts	6,346		5,360
Inventories	2,465		2,454
Deferred income taxes	2,363		2,904
Prepaid expenses and other current assets	852		425
Total current assets	42,109		40,925
Property and equipment, net	1,862		1,948
Deferred income taxes	5,888		6,761
Intangible assets, net	2,124		2,578
Goodwill	17,318		17,318
Other assets	210		210
Total assets	\$ 69,511	\$	69,740
<b>Liabilities and stockholders equity</b>			
Current liabilities:			
Trade accounts payable	\$ 5,411	\$	4,044
Accrued payroll and related expenses	3,374		3,398
Accrued liabilities	1,979		2,942
Billings in excess of costs and estimated earnings on uncompleted contracts	1,958		1,542
Current portion of long-term debt			634
Total current liabilities	12,722		12,560
Deferred rent	312		700
Unrecognized tax benefits	286		351
Other non-current liabilities	310		657
Total liabilities	13,630		14,268
Commitments and contingencies			
Stockholders equity:			
Preferred stock, \$1.00 par value:			
Authorized shares - 2,000			
Issued and outstanding shares - none			
Common stock, \$0.10 par value:			
Authorized shares - 70,000 at March 31, 2013 and March 31, 2012			
Issued and outstanding shares - 33,626 at March 31, 2013 and 33,909 at March 31, 2012	3,264		3,391
Additional paid-in capital	135,802		137,645
Accumulated deficit	(83,185)		(85,564)
Total stockholders equity	55,881		55,472
Total liabilities and stockholders equity	\$ 69,511	\$	69,740

See accompanying notes.





Table of Contents**Iteris, Inc.****Consolidated Statements of Operations****(In thousands, except per share amounts)**

	2013	Year Ended March 31,		2011
		2012		
Total revenues	\$ 61,685	\$ 58,406	\$ 51,966	
Cost of revenues	38,427	35,335	29,082	
Gross profit	23,258	23,071	22,884	
Operating expenses:				
Selling, general and administrative	18,090	17,986	16,981	
Research and development	3,071	3,183	2,444	
Amortization of intangible assets	644	504	176	
Change in fair value of contingent consideration	(181)	(619)	55	
Impairment of goodwill			7,970	
Total operating expenses	21,624	21,054	27,626	
Operating income (loss)	1,634	2,017	(4,742)	
Non-operating income (expense):				
Other income, net	2	4	18	
Interest expense, net	(6)	(72)	(152)	
Income (loss) from continuing operations before income taxes	1,630	1,949	(4,876)	
Provision for income taxes	(716)	(643)	(278)	
Income (loss) from continuing operations	914	1,306	(5,154)	
Gain on sale of discontinued operation, net of tax	1,465	1,180		
Income (loss) from discontinued operation, net of tax		28	(55)	
Net income (loss)	\$ 2,379	\$ 2,514	\$ (5,209)	
Income (loss) per share from continuing operations - basic and diluted	\$ 0.03	\$ 0.04	\$ (0.15)	
Gain per share from sale of discontinued operation - basic and diluted	\$ 0.04	\$ 0.03	\$ 0.00	
Income (loss) per share from discontinued operation - basic and diluted	\$ 0.00	\$ 0.00	\$ (0.00)	
Net income (loss) per share - basic and diluted	\$ 0.07	\$ 0.07	\$ (0.15)	
Shares used in basic per share calculations	33,491	34,259	34,335	
Shares used in diluted per share calculations	33,609	34,380	34,335	

See accompanying notes.

Table of Contents**Iteris, Inc.****Consolidated Statements of Stockholders Equity and Comprehensive Income (Loss)****(In thousands)**

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders Equity
Balance at March 31, 2010	34,318	\$ 3,432	\$ 137,503	\$ (82,869)	\$ 58,066
Stock option exercises	46	4	53		57
Stock-based compensation			382		382
Net loss and comprehensive loss				(5,209)	(5,209)
Balance at March 31, 2011	34,364	3,436	137,938	(88,078)	53,296
Stock option exercises	68	8	77		85
Stock-based compensation			331		331
Issuance of shares pursuant to vesting of restricted stock units	51	5	(5)		
Repurchases of common stock	(574)	(58)	(696)		(754)
Net income and comprehensive income				2,514	2,514
Balance at March 31, 2012	33,909	3,391	137,645	(85,564)	55,472
Stock option exercises	190	20	232		252
Stock-based compensation			279		279
Issuance of shares pursuant to vesting of restricted stock units	51	5	(29)		(24)
Repurchases of common stock	(1,524)	(152)	(2,325)		(2,477)
Net income and comprehensive income				2,379	2,379
Balance at March 31, 2013	32,626	\$ 3,264	\$ 135,802	\$ (83,185)	\$ 55,881

See accompanying notes.

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## Iteris, Inc.

## Consolidated Statements of Cash Flows

(In thousands)

	Year Ended March 31,		
	2013	2012	2011
<b>Cash flows from operating activities</b>			
Net income (loss)	\$ 2,379	\$ 2,514	\$ (5,209)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Deferred income taxes	1,414	286	273
Depreciation of property and equipment	901	907	1,030
Stock-based compensation	279	331	382
Impairment of goodwill			7,970
Amortization of intangible assets	644	504	222
Change in fair value of contingent consideration	(181)	(619)	55
Gain on sale of discontinued operation, net of tax	(1,465)	(1,180)	
Loss on disposal of equipment		1	9
Changes in operating assets and liabilities, net of effects of discontinued operation:			
Accounts receivable	135	(1,826)	1,052
Net costs and estimated earnings in excess of billings	(570)	(902)	(501)
Inventories	(11)	79	(953)
Prepaid expenses and other assets	(334)	284	211
Accounts payable and accrued expenses	461	289	805
Net cash provided by operating activities	3,652	668	5,346
<b>Cash flows from investing activities</b>			
Purchases of property and equipment	(815)	(337)	(414)
Capitalized software	(190)	(138)	
Cash paid for business combination		(969)	(1,116)
Net proceeds from sale of business segment	1,372	11,446	
Net cash provided by (used in) investing activities	367	10,002	(1,530)
<b>Cash flows from financing activities</b>			
Payments on long-term debt	(634)	(2,330)	(2,354)
Deferred payment for prior business combination	(700)	(788)	(106)
Repurchases of common stock	(2,477)	(754)	
Proceeds from stock option exercises	252	85	57
Issuance of common stock pursuant to restricted stock units	(24)		
Net cash used in financing activities	(3,583)	(3,787)	(2,403)
Increase in cash and cash equivalents	436	6,883	1,413
Cash and cash equivalents at beginning of period	18,701	11,818	10,405
Cash and cash equivalents at end of period	\$ 19,137	\$ 18,701	\$ 11,818
<b>Supplemental cash flow information:</b>			
Cash paid during the year for:			
Interest	\$ 45	\$ 111	\$ 200
Income taxes	339	439	455

**Supplemental schedule of non-cash investing and financing activities:**

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Liabilities incurred for business combinations	\$	\$	971	\$	2,610
Issuance of common stock for vested restricted stock units		5	5		

See accompanying notes.

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**Iteris, Inc.**

**Notes to Consolidated Financial Statements**

**March 31, 2013**

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

**Description of Business**

Iteris, Inc. (referred to collectively with our subsidiaries in these consolidated financial statements as Iteris, the Company, we, our and us ) is 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. Iteris was originally incorporated in Delaware in 1987.

**Basis of Presentation**

Our consolidated financial statements include the accounts of Iteris and our subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ). All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of continuing operations for all periods presented in the consolidated financial statements exclude the financial impact of discontinued operations. See Note 3, Sale of Vehicle Sensors , for further discussion related to discontinued operations presentation.

**Use of Estimates**

The preparation of consolidated financial statements in conformity with GAAP 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 asset 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

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 under the terms of the arrangement 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 relative 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.

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

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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 elements and is recognized as revenue.

Transportation Systems revenues are derived primarily from long-term contracts with governmental agencies. When appropriate, revenues are recognized using the percentage of completion method of accounting, whereby revenue is recognized as contract performance progresses and is 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 revenues when their realization is reasonably assured. Certain of our revenues are recognized as services are performed and amounts are earned, which is measured by time incurred or other contractual milestones or output measures. Revenues accounted for in this manner generally relate to certain cost-plus fixed fee or time-and-materials contracts.

**Costs in Excess of Billings on Uncompleted Contracts**

Costs in excess of billings on uncompleted contracts in the accompanying 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 will become billable according to contract terms, which usually require the consideration of the passage of time, achievement of milestones or completion of the project. Such unbilled amounts are expected to be billed and collected within the next twelve months.

Costs in excess of billings on uncompleted contracts at March 31, 2013 and 2012 include approximately \$937,000 and \$944,000, respectively, which were not billable because certain milestone objectives specified in the contracts had not been attained. The costs and estimated earnings in excess of billings at March 31, 2013 are expected to be billed and collected during the fiscal year ending March 31, 2014.

**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 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 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 contract closeout settlements.



**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 are believed to have minimal credit risk.

Our accounts receivable are primarily derived from billings with customers located throughout North America, as well as in the Middle East, Europe, South America and Asia. 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.

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**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. Included in cash and cash equivalents of \$19.1 million as of March 31, 2013, is approximately \$500,000 of cash designated as collateral on performance bonds, as required under certain of our Transportation Systems contracts in the Middle East. The performance bonds require us to maintain 100% cash value of the bonds as collateral in a bank that is local to the purchasing agency. The performance bond collateral is required throughout the delivery of our services and until the contract is closed by the purchasing agency. We expect these requirements, and the related cash collateral restrictions, to remain in place through 2014.

**Allowance for Doubtful Accounts**

The collectability of our accounts receivable is evaluated through review of outstanding invoices 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 consist of finished goods, work-in-process and raw materials and 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

We evaluate goodwill on an annual basis in our fourth fiscal quarter or more frequently if we believe indicators of impairment exist. We have determined that our reporting units for purposes of testing for goodwill impairment are identical to our reportable segments for financial reporting purposes. In the fiscal year ended March 31, 2012 ( Fiscal 2012 ) we adopted the provisions issued by the Financial Accounting Standards Board ( FASB ) that were intended to simplify goodwill impairment testing. This guidance permits us to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, we conduct a two-step goodwill impairment test. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their carrying values. We determine the fair values of our reporting units using the income valuation approach, as well as other generally accepted valuation methodologies. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, we perform the second step of the goodwill impairment test. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill. The amount by which the carrying value of the goodwill exceeds its implied fair value, if any, is recognized as an impairment loss. We performed an annual impairment assessment of the carrying value of goodwill for each of the fiscal years ended March 31, 2013, 2012 and 2011. Based on these assessments, we determined that no impairment as of each of these dates was indicated as the estimated fair value of each of our reporting units exceeded its respective carrying 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. Refer to Note 5 for additional discussion regarding our interim goodwill impairment analysis during the fiscal year ended March 31, 2011 ( Fiscal 2011 ).

We test long-lived assets and purchased intangible assets (other than goodwill) for impairment if we believe indicators of impairment exist. We determine whether the carrying value of an asset or asset group is recoverable, based on comparisons to undiscounted expected future cash flows the asset are expected to generate. If an asset is not recoverable, we record an impairment loss equal to the amount by which the carrying value of the asset exceeds its fair value. We primarily use the income valuation approach to determine the fair value of our long lived assets and purchased intangible assets.

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**Income Taxes**

We utilize the asset and liability method of accounting for income taxes, under which deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more-likely-than-not that some or all of the deferred tax assets will not be realized, which increases our income tax expense in the period such determination is made.

Income tax positions must meet a more-likely-than-not recognition threshold to be recognized. Income tax positions that previously failed to meet the more-likely-than-not threshold are recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

**Stock-Based Compensation**

We record stock-based compensation in the consolidated statement of operations as an expense, based on the estimated grant date fair value of our stock-based awards, whereby such fair values are amortized over the requisite service period. Our stock-based awards are currently comprised of common stock options and restricted stock units. The fair value of our common stock option awards is estimated on the grant date using the Black-Scholes-Merton ( BSM ) option-pricing formula. While utilizing this model meets established requirements, the estimated fair values generated by it may not be indicative of the actual fair values of our common stock option awards as it does not consider certain factors important to those awards to employees, such as continued employment and periodic vesting requirements as well as limited transferability. The fair value of our restricted stock units is based on the closing market price of our common stock on the grant date. If there are any modifications or cancellations of the underlying unvested stock-based awards, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense.

**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 consolidated statements of operations.

### **Advertising Expenses**

Advertising costs are expensed in the period incurred and totaled \$165,000, \$187,000 and \$224,000 in the fiscal years ended March 31, 2013, 2012 and 2011, respectively.

### **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 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 consolidated balance sheets.

### **Repair and Maintenance Costs**

We incur repair and maintenance costs in the normal course of business. Should the repair or maintenance result in a permanent improvement to one of our leased facilities, the cost is capitalized as a leasehold improvement and amortized over its useful life or the remainder of the lease period, whichever is shorter. Non-permanent repair and maintenance costs are charged to expense as incurred.

Table of Contents**Recent Accounting Pronouncements**

In May 2011, the 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 under GAAP. Additionally, among other disclosures, this ASU requires certain new quantitative and qualitative disclosures regarding unobservable fair value measurements. We adopted the amendments prescribed by ASU 2011-04 for our fiscal year ended March 31, 2013 ( Fiscal 2013 ), which has not resulted in a material impact on our consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* ( ASU 2011-05 ). ASU 2011-05 requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented; however, in December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, which deferred this requirement. The amendments prescribed by ASU 2011-05 are now effective on a retrospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. We adopted ASU 2011-05 in Fiscal 2013, which has not resulted in a material impact on our consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, *Testing for Goodwill Impairment* ( ASU 2011-08 ). With respect to performing their required annual test for goodwill impairment, ASU 2011-08 gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If a company concludes that this is the case, it must perform the two-step test in accordance with previously existing guidance. Otherwise, a company can skip the two-step test. ASU 2011-08 is effective for fiscal years beginning after December 15, 2011. Early adoption was permitted, and we chose to adopt ASU 2011-08 in Fiscal 2012, which did not result in a material impact on our consolidated financial statements.

**2. Supplementary Financial Information****Inventories**

The following table presents details regarding our inventories:

	2013	March 31, (In thousands)	2012
Materials and supplies	\$	1,504	\$ 1,513
Work in process		105	98
Finished goods		856	843
	\$	2,465	\$ 2,454

**Property and Equipment**

The following table presents details of our property and equipment:

	2013	March 31, (In thousands)	2012
Equipment	\$	6,126	\$ 5,545
Leasehold improvements		1,953	1,946
Accumulated depreciation		(6,217)	(5,543)
	\$	1,862	\$ 1,948

Table of Contents**Intangible Assets**

The following table presents details regarding our intangible assets:

	2013		March 31,		2012	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
(In thousands)						
Technology	\$ 1,856	\$ (1,178)	\$ 1,856	\$ (935)		
Customer contracts / relationships	750	(247)	750	(122)		
Trade names and non-compete agreements	1,110	(495)	1,110	(219)		
Capitalized software development costs	328		138			
Total	\$ 4,044	\$ (1,920)	\$ 3,854	\$ (1,276)		

Amortization expense for intangible assets subject to amortization was approximately \$644,000, \$504,000 and \$176,000 for the fiscal years ended March 31, 2013, 2012 and 2011, respectively.

We capitalized approximately \$190,000 and \$138,000 for the fiscal years ended March 31, 2013 and 2012, respectively, of internal costs incurred in developing software products to be sold. These costs related to the internal development of our performance measurement software offerings.

We do not have any intangible assets with indefinite useful lives. Future estimated amortization expense is as follows:

Year Ending March 31, (In thousands)	
2014	\$ 736
2015	540
2016	469
2017	282
2018	88
Thereafter	9
	\$ 2,124

Refer to Note 4 for additional information regarding intangible assets acquired during the last three fiscal years. If we acquire additional intangible assets in future periods, our amortization expense will increase.



**Goodwill**

The following table presents the activity related to the carrying value of our goodwill by reportable segment for Fiscal 2012 and Fiscal 2013:

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	Roadway Sensors	Transportation Systems	iPerform	Total
	(In thousands)			
Balance - March 31, 2011				
Goodwill	8,214	16,278		24,492
Accumulated impairment losses		(7,970)		(7,970)
	8,214	8,308		16,522
Acquisition of Berkeley Transportation Systems, Inc. (Note 4)				
		796		796
Balance - March 31, 2012				
Goodwill	8,214	17,074		25,288
Accumulated impairment losses		(7,970)		(7,970)
	\$ 8,214	\$ 9,104	\$	\$ 17,318
Balance - March 31, 2013				
Goodwill	8,214	16,278	796	25,288
Accumulated impairment losses		(7,970)		(7,970)
	\$ 8,214	\$ 8,308	\$ 796	\$ 17,318

**Warranty Reserve Activity**

The following table presents activity with respect to the warranty reserve:

Balance at beginning of fiscal year	\$	231	\$	279	\$	297
Additions charged to cost of sales		139		86		137
Warranty claims		(201)		(134)		(155)
Balance at end of fiscal year	\$	169	\$	231	\$	279

**Earnings Per Share**

The following table sets forth the computation of basic and diluted income (loss) from continuing operations per share:

	2013	Year Ended March 31, 2012	2011
	(In thousands, except per share amounts)		
Numerator:			
Income (loss) from continuing operations	\$ 914	\$ 1,306	\$ (5,154)
Denominator:			
	33,491	34,259	34,335

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Weighted average common shares used in basic computation			
Dilutive stock options	60	96	
Dilutive restricted stock units	56	25	
Dilutive warrants	2		
Weighted average common shares used in diluted computation	33,609	34,380	34,335
Income (loss) from continuing operations per share:			
Basic	\$ 0.03	\$ 0.04	\$ (0.15)
Diluted	\$ 0.03	\$ 0.04	\$ (0.15)

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

	2013	Year Ended March 31, 2012 (In thousands)	2011
Stock options	1,049	1,840	1,467
Restricted stock units			54
Warrants	4	15	272

### 3. Sale of Vehicle Sensors

On July 29, 2011, we completed the sale of substantially all of our 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 (the Agreement ) signed on July 25, 2011 (the Asset Sale ).

Under the terms of the Agreement, upon the closing of the Asset Sale, 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 the following performance and royalty-related earn-outs: Bendix is obligated to pay us 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 and 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. As of March 31, 2013, we received approximately \$0.9 million in connection with royalty-related earn-outs provisions for a total of \$14.6 million in cash from the Asset Sale.

Upon the closing of the Asset Sale and resolution of working capital adjustments (as described above), we recorded aggregate proceeds received of approximately \$12.0 million. Legal and other professional fees of approximately \$0.6 million that were directly related to the sale transaction were offset against the proceeds to calculate net proceeds from the Asset Sale of approximately \$11.4 million.

The following table summarizes the assets and liabilities of the Vehicle Sensors segment as of the closing date of the Asset Sale (in thousands):

Cash	\$	105
Accounts receivable		1,850
Inventories		1,147
Other current assets		31
Property and equipment, net		133
Goodwill		4,671
Total assets		7,937

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Current liabilities		(691)
Net assets	\$	7,246

In comparing the above net assets to the net proceeds received, we recorded a gain on the Asset Sale of \$1.5 million and \$1.2 million, after tax, in the accompanying consolidated statements of operations for Fiscal 2013 and Fiscal 2012, respectively. The effective tax rate applicable to the gain was impacted by goodwill of \$4.7 million for Fiscal 2012, for which there is no corresponding tax basis. Included in the \$1.5 million gain on the Asset Sale in Fiscal 2013, is an accrual for approximately \$90,000, or \$58,000 after tax, related to certain performance and royalty-related earn-outs (as described above) that were achieved through March 31, 2013.

In accordance with applicable accounting guidance, we determined that the Vehicle Sensors segment, which constituted one of our operating segments, qualified as a discontinued operation. The applicable financial results of the Vehicle Sensors segment have been reported as a discontinued operation in the consolidated statements of operations for all periods presented. For the fiscal years ended March 31, 2013, 2012 and 2011, Vehicle Sensors net sales classified as part of discontinued operation was \$0, \$3.2 million and \$7.5 million, respectively. We elected not to allocate any interest expense to the discontinued operation.

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We entered into a short-term transitional services agreement with Bendix that terminated at the end of February 2012, pursuant to which we provided them certain ongoing logistical and administrative support services. Bendix paid us a fixed monthly amount for such support services, and also paid us an hourly amount for providing certain development-related services during the transition period.

**4. Acquisitions**

**Berkeley Transportation Systems, Inc.**

In November 2011, we acquired all of the outstanding capital stock of Berkeley Transportation Systems, Inc. ( *BTS* ). *BTS* was a privately-held company based in Berkeley, California, which specializes in transportation performance measurement. *BTS* Performance Measurement System leverages its real-time data collection, diagnostic, fusion and warehousing platform to aggregate and compute performance measures. This information is used to analyze how a transportation system is performing based on pre-determined measures of effectiveness such as stops, delays and travel time. Our primary reasons for the acquisition were to add key technologies to complement our iPerform solutions and strengthen our performance measurement and management initiative as a whole.

Our consolidated financial statements for Fiscal 2013 and Fiscal 2012 include the results of operations of *BTS* commencing as of the acquisition date. *BTS* contributed approximately \$3.3 million and \$935,000 of revenues and approximately \$294,000 and \$367,000 of operating losses included in the consolidated statement of operations for Fiscal 2013 and Fiscal 2012, respectively. On or shortly after the acquisition date, we paid a total of approximately \$840,000 in cash to *BTS*. Additionally, we are also scheduled to pay up to \$250,000 at the 24-month anniversary of the closing of the acquisition, pursuant to a holdback provision, and up to \$335,000 at the 36-month anniversary of the closing of the acquisition, pursuant to a deferred payment provision. In our third fiscal quarter ended December 31, 2012, the Company entered into an amendment to the *BTS* stock purchase agreement which modified certain earn-out provisions, and as a result, the Company paid \$700,000 in cash to the *BTS* shareholders for achievement of those modified earn-out provisions in our fourth quarter of Fiscal 2013. The amendment did not have a material impact on previous estimated amounts accrued in connection with the earn-out provisions. This payment completed the Company's obligation under the earn-out provisions of the agreement.

*Acquisition Accounting*

We accounted for the acquisition of *BTS* as a business combination in accordance with applicable accounting guidance. We measured the fair value of the consideration transferred (including contingent consideration) to determine the purchase price of the acquisition. We allocated the fair value of consideration transferred to tangible assets acquired, liabilities assumed and identifiable intangible assets acquired based on their estimated fair values at the acquisition date.

The *BTS* acquisition was recorded as follows (in thousands):

<b>Fair value of consideration transferred:</b>		
Cash paid on or shortly after acquisition date	\$	840

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Estimated fair value of contingent consideration	971
Total	1,811
<b>Allocation:</b>	
Accounts receivable	(164)
Other tangible assets	(375)
Purchased intangible assets	(1,100)
Liabilities	624
Goodwill	\$ 796

The excess of the fair value of the BTS business over the aggregate fair values of identifiable assets acquired and liabilities assumed was recorded as goodwill. The primary factor that resulted in the recognition of goodwill was the acquisition of BTS assembled workforce, which is not a separately identifiable intangible asset. The goodwill is not expected to be deductible for income tax purposes.

*Purchased Intangible Assets*

The following table presents details of the intangible assets acquired from BTS:

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	<b>Estimated Useful Life (In years)</b>	<b>Amount (In thousands)</b>
Backlog	3	\$ 330
Technology	6	290
Customer contracts / relationships	6	250
Other purchased intangible assets	5 - 7	230
		<b>\$ 1,100</b>

**Meridian Environmental Technology, Inc.**

In January 2011, we acquired all of the capital stock of Meridian Environmental Technology, Inc. ( MET ), a privately-held company based in Grand Forks, North Dakota. MET specializes in 511 advanced traveler information systems, as well as Maintenance Decision Support System management tools that allow users to create solutions to meet roadway maintenance decision needs. Our primary reasons for the acquisition were (i) to enhance our ability to provide travelers and traffic management authorities with more accurate and real-time information and network performance management tools and (ii) to provide Iteris with key capabilities in the emerging performance measurement and management market. From the date of acquisition through the end of Fiscal 2011, MET contributed approximately \$1.5 million of revenues and approximately \$77,000 of operating income included in the consolidated statement of operations for Fiscal 2011.

Our consolidated financial statements for the fiscal years ended March 31, 2013, 2012 and 2011 include the results of operations of MET commencing as of the acquisition date. On or shortly after the acquisition date, we paid approximately \$1.6 million in cash, exclusive of \$369,000 of cash acquired. We also agreed to pay up to \$1 million on each of the first two anniversaries of the closing of the acquisition upon the satisfaction of certain conditions, as well as up to an additional \$2 million under a 24-month earn-out provision. Acquisition-related costs were not significant and are included in selling, general and administrative expenses in the accompanying consolidated statement of operations for Fiscal 2011.

In January 2012, we made a cash payment of approximately \$668,000 of the first deferred payment to the shareholders of MET and held back \$250,000 in accordance with certain provisions of the purchase agreement. In June 2012, we determined the contingencies related to the release of the \$250,000 holdback were not met. As a result, no portion of the \$250,000 holdback was released and the entire amount was reversed into operating income during the second quarter of Fiscal 2013. Additionally, no amounts were earned by the MET shareholders related to the first and second year earn-out provisions which ended on December 31, 2011 and 2012, respectively. The second deferred payment of \$1 million was due in the fourth quarter of Fiscal 2013. As a result of certain holdback provisions and other deductions, we currently expect to pay approximately \$400,000 to the MET shareholders in the first quarter of the fiscal year ending March 31, 2014, which is recorded in our accrued liabilities in our consolidated balance sheet at March 31, 2013.

*Acquisition Accounting*

We accounted for the acquisition of MET as a business combination in accordance with applicable accounting guidance. We measured the fair value of the consideration transferred (including contingent consideration) to determine the purchase price of the acquisition. We allocated the fair value of consideration transferred to tangible assets acquired, liabilities assumed and identifiable intangible assets acquired based on their estimated fair values at the acquisition date.



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The acquisition is recorded as follows (in thousands):

<b>Fair value of consideration transferred:</b>		
Cash paid on or shortly after acquisition date	\$	1,622
Estimated fair value of contingent consideration		2,473
Total		4,095
<b>Allocation:</b>		
Cash		(369)
Accounts receivable		(682)
Other tangible current assets		(531)
Property and equipment		(682)
Purchased intangible assets		(1,620)
Liabilities		1,161
Goodwill	\$	1,372

The excess of the fair value of the business over the aggregate fair values of identifiable assets acquired and liabilities assumed was recorded as goodwill. The primary factor that resulted in the recognition of goodwill was the acquisition of MET s

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assembled workforce, which is not a separately identifiable intangible asset. The goodwill is not expected to be deductible for income tax purposes.

*Purchased Intangible Assets*

The following table presents details of the intangible assets acquired from MET:

	<b>Estimated Useful Life (In years)</b>	<b>Amount (In thousands)</b>
Technology	6	\$ 570
Customer contracts / relationships	6	500
Other purchased intangible assets	3 - 7	550
		\$ 1,620

**5. Impairment of Goodwill**

As discussed in Note 1, goodwill is tested for impairment on an annual basis in our fourth fiscal quarter or more frequently if indicators of impairment exist.

In Fiscal 2012, we early adopted the provisions issued by the FASB that are intended to simplify goodwill impairment testing. The updated guidance permits us to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If we conclude that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, we conduct a two-step goodwill impairment test. We determined it was more appropriate and cost effective to perform a qualitative assessment in Fiscal 2012 and a quantitative first-step assessment in Fiscal 2013 to estimate the fair value of our reporting units using the income approach. Based on our assessments, we determined that no impairment was indicated as the estimated fair value of each reporting unit exceeded its respective carrying value.

In Fiscal 2011, during the quarter ended December 31, 2010, due primarily to lower than expected operating results in our Transportation Systems reporting unit, as well as ongoing weakness specifically in the Transportation Systems markets, we performed an interim test of impairment of the carrying value of goodwill in our Transportation Systems reporting unit as of December 31, 2010. In performing the first step in this analysis, we estimated the fair value of our Transportation Systems reporting unit using the income approach. As of December 31, 2010, we determined that the carrying value of our Transportation Systems reporting unit exceeded its estimated fair value and, accordingly, we performed the second step of the impairment analysis to estimate the implied fair value of the goodwill of this reporting unit.

The implied fair value of goodwill was determined in the same manner utilized to estimate the amount of goodwill recognized in a business combination. To determine this value, we estimated the fair value of the assets and liabilities, including certain intangible assets, to be allocated to the Transportation Systems reporting unit as of December 31, 2010. The implied fair value of goodwill was measured as the difference

between the estimated fair value of the reporting unit over the estimated fair value amounts of its assets and liabilities. The impairment loss for the Transportation Systems reporting unit was measured as the amount the carrying value of its goodwill exceeded the implied fair value of the goodwill. Accordingly, in order to write down Transportation Systems goodwill with a carrying value of \$14.9 million to its implied fair value of \$6.9 million, we recorded an impairment charge of \$8.0 million in the three months ended December 31, 2010.

We estimated the fair value of the Transportation Systems reporting unit using the income approach, which was based on management's business plans and financial projections at that time for the next five years, along with a perpetual growth rate thereafter of approximately 4%. The analysis also used a weighted average discount rate of approximately 14%, our estimated cost of capital, slightly adjusted for increased market risk.

## **6. 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.

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The liability for the estimated fair value of the contingent consideration in connection with our acquisitions of MET and BTS 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 Fiscal 2013 (in thousands):

Balance at March 31, 2012	\$	2,204
Deferred payments made to BTS shareholders		(700)
Payments made or accrued to reduce MET liability		(362)
Change in fair value included in net income		(181)
Balance at March 31, 2013	\$	961

The change in the estimated fair value of this liability during the current fiscal year resulted primarily from payments to the shareholders of BTS related to the achievement of earn-out targets and reductions to our MET estimates regarding both the probability of achieving certain earn-out targets and the amounts of certain future deferred payments.

The current portions of the liability at March 31, 2013 and 2012 were approximately \$652,000 and \$1.6 million, respectively, and were included within accrued liabilities in the accompanying consolidated balance sheets. The remaining non-current portions of the liability are included within non-current liabilities in the accompanying consolidated balance sheets.

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 March 31, 2013.

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. See Notes 4 and 5 above for further discussion regarding certain of our intangible assets and goodwill balances (including goodwill impairment) that were measured at fair value, using certain Level 3 inputs, during the fiscal years ended March 31, 2013 and 2012.

## 7. Credit Facility

In October 2008, we entered into a \$19.5 million credit facility with California Bank & Trust ( CB&T ). This credit facility provided for a two-year revolving line of credit with borrowings of up to \$12.0 million and a \$7.5 million 48-month term note. In September 2010, we entered into a modification agreement with CB&T to extend the expiration date of our revolving line of credit to October 1, 2012. In September 2012, we entered into a second modification agreement with CB&T to extend the expiration date of our revolving line of credit to October 1, 2014. 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 March 31, 2013) up to the current stated prime rate plus 0.25%, 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 early termination fees and is secured by substantially all of our assets. As of March 31, 2013 and March 31, 2012, no amounts were borrowed under the revolving line of credit portion of the credit 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.

As of March 31, 2012, we had outstanding borrowings of approximately \$634,000 under the term note, which was set to expire on May 1, 2013. Principal payments under this term note were required to be repaid in monthly installments of \$152,000. During the first quarter of Fiscal 2013, all principal and interest payments under the term note were paid in full. The term note contained no early termination fees.

**8. Income Taxes**

The reconciliation of our income tax provision (benefit) to taxes computed at U.S. federal statutory rates is as follows:

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	2013	Year Ended March 31, 2012 (In thousands)		2011
Income tax provision (benefit) at statutory rates	\$ 554	\$ 663	\$	(1,658)
State income taxes net of federal benefit	18	562		189
Impairment charges				2,044
Research credits	(39)	(246)		
Change in fair value of contingent acquisition consideration	(62)	(211)		
Compensation charges	31	59		94
Unrecognized tax benefits		(276)		(288)
Change in valuation allowance	188			
Other	26	92		(103)
Provision for income taxes	\$ 716	\$ 643	\$	278

The components of deferred tax assets and liabilities are as follows:

	2013	March 31, 2012 (In thousands)	
Deferred tax assets:			
Net operating losses	\$ 7,031	\$	8,246
Credit carry forwards	960		773
Deferred compensation and payroll	913		941
Bad debt allowance and other reserves	462		433
Deferred rent	315		435
Other, net	156		301
Total deferred tax assets	9,837		11,129
Valuation allowance	(188)		
Total deferred tax assets, net of valuation allowance	9,649		11,129
Deferred tax liabilities:			
Property and equipment	(482)		(517)
Acquired intangibles	(535)		(754)
Goodwill	(381)		(193)
Total deferred tax liabilities	(1,398)		(1,464)
Net deferred tax assets	\$ 8,251	\$	9,665

The components of current and deferred federal and state income tax provisions and (benefits) are as follows:

	2013	Year Ended March 31, 2012 (In thousands)		2011
Current income tax provision (benefit):				
Federal	\$ (20)	\$ (221)	\$	(186)
State	99	208		264
Deferred income tax provision (benefit):				
Federal	425	12		251
State	212	644		(51)
Net income tax provision	\$ 716	\$ 643	\$	278

At March 31, 2013, we had approximately \$587,000 in federal alternative minimum tax credit carryforwards that can be carried forward indefinitely. We had \$22.0 million of federal net operating loss carryforwards at March 31, 2013 that begin to expire in 2021. We also had \$9.2 million of state net operating loss carryforwards at March 31, 2013, of which \$420,000 are scheduled to expire in 2014, \$8.5 million are scheduled to expire in 2015 and \$298,000 are scheduled to expire in 2031.

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Due to changes in stock ownership, our federal net operating loss carryforwards of approximately \$22.0 million as of March 31, 2013 and other federal attributes are subject to an annual limitation under Section 382 of the Internal Revenue Code. As of March 31, 2013, based on the cumulative amount of tax attributes that have become available under the limitation imposed by Section 382, all of our net operating losses are now fully available for use. Our deferred tax assets at March 31, 2013 do not include approximately \$906,000 of excess tax benefits from employee stock option exercises that are a component of our net operating loss carryforwards. If and when such excess tax benefits are realized, stockholders' equity will be increased.

As of March 31, 2013, we recorded a valuation allowance against certain of our state net operating loss carryforwards in the amount of \$188,000, net of federal tax benefit, which we estimated were more likely to not be realized within the applicable carryforward period. As of March 31, 2012, we determined that it was more likely than not that our deferred tax assets would be realized and no general valuation allowance was recorded against our deferred tax assets. In making our determination as to the realizability of our deferred tax assets, we reviewed all available positive and negative evidence, including reversal of deferred tax liabilities, potential carrybacks, projected future taxable income, tax planning strategies and recent financial performance.

**Unrecognized Tax Benefits**

As of March 31, 2013 and 2012, our gross unrecognized tax benefits were \$218,000 and \$1.7 million, respectively, of which \$115,000 and \$1.3 million, respectively, if recognized, would affect our effective tax rate.

We recognize interest and/or penalties related to income tax matters in income tax expense. As of March 31, 2013 and 2012, we had accrued cumulatively \$68,000 and \$56,000, respectively, for the payment of potential interest and penalties.

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows:

	2013	Year Ended March 31, 2012	2011
		(In thousands)	
Gross unrecognized tax benefits at beginning of year	\$ 1,692	\$ 1,941	\$ 2,153
Increases for tax positions taken in prior years		97	121
Decreases for tax positions taken in prior years	(1,431)	(10)	(15)
Increases for tax positions taken in the current year	17	20	17
Settlement with taxing authorities			(8)
Lapse in statute of limitations	(60)	(356)	(327)
Gross unrecognized tax benefits at March 31	\$ 218	\$ 1,692	\$ 1,941

As of March 31, 2012, our unrecognized tax benefits included \$1.4 million related to estimated tax credit carryforwards which, if recognized, would have given rise to a deferred tax asset. As of March 31, 2013, we concluded that the information necessary to compute and substantiate the credits was not available or reasonably obtainable. As such, we will neither recognize a deferred tax asset for the estimated credit carryforwards, nor continue maintaining an offsetting amount of unrecognized tax benefits. We anticipate a decrease in gross unrecognized tax benefits of approximately \$30,000 within the next twelve months based on federal and state statute expirations in various jurisdictions.



We are subject to taxation in the U.S. and various states. We are subject to U.S. federal tax examination for fiscal tax years ended March 31, 2010 or later, and state and local income tax examination for fiscal tax years ended March 31, 2009 or later.

**9. Commitments and Contingencies**

**Litigation and Other Contingencies**

As a provider of traffic engineering services, products and solutions, we are currently, and may in the future, from time to time, be involved in litigation relating to claims arising out of our operations in the normal course of business. While we cannot accurately predict the outcome of such litigation, we currently are not a party to any legal proceedings, the adverse outcome of which, in management's opinion, individually or in the aggregate, would have a material adverse effect on our consolidated results of operations, financial position or cash flows.

**Operating Leases**

In May 2007, we entered into an agreement to lease 52,000 square feet of office space in Santa Ana, California for a term of 88 months. In September 2007, we relocated our headquarters and principal operations into this space. The monthly lease rate was \$102,000 during the first year of the lease and increases each year thereafter, up to a maximum of \$120,000 during the last year of the lease. The lease may be extended for a period of five years, at our option, at a lease rate to be based on the market lease rate for comparable property determined as of the commencement date of the extension period. Additionally, the lease agreement provided for \$1.8 million in incentives in the form of tenant improvement allowances, which we recorded as deferred rent and capitalized leasehold improvements in our consolidated balance sheet. The deferred rent amount reduces monthly rent expense over the term of the lease, and the capitalized leasehold improvements amount are being depreciated over the initial term of the lease (the estimated useful life of the related leasehold improvements).

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We have lease commitments for facilities in various locations throughout the U.S., as well as for certain equipment. Future minimum rental payments under these non-cancelable operating leases at March 31, 2013 were as follows:

<b>Year Ending March 31, (In thousands)</b>		
2014	\$	2,251
2015		1,723
2016		526
2017		431
2018		311
Thereafter		172
	\$	5,414

Rent expense totaled approximately \$1.9 million for each of the fiscal years ended March 31, 2013, 2012 and 2011, respectively.

**Related Party Transaction**

We previously subleased office space to MAXxess Systems, Inc. ( MAXxess ), one of our former subsidiaries that we sold in September 2003. MAXxess is currently owned by an investor group that includes two of our directors, one of whom is the former Chief Executive Officer of MAXxess. The sublease terminated in September 2007, at which time MAXxess owed us an aggregate of \$274,000 related to this sublease and certain ancillary corporate services that we provided to MAXxess. We have previously fully reserved for amounts owed to us by MAXxess under the terms of this sublease. In August 2009, MAXxess executed a promissory note payable to Iteris in the original principal amount of \$274,000. The promissory note bears interest at a rate of 6% per annum, compounded annually, with accrued interest to be paid annually on the first business day of each calendar year. Payments under the note may be made in bona fide services rendered by MAXxess to Iteris to the extent such services and amounts are pre-approved in writing by us. All amounts outstanding under the note will become due and payable on the earliest of (i) August 10, 2014, (ii) a change of control in MAXxess, or (iii) a financing by MAXxess resulting in gross proceeds of at least \$10 million. As of March 31, 2013, approximately \$259,000 of the original principal balance and interest for calendar year 2012 of approximately \$15,000 was outstanding and payable to Iteris. Subsequent to March 31, 2013, the interest payment was received in full. All outstanding principal remains fully reserved.

**Inventory Purchase Commitments**

At March 31, 2013, we had firm commitments to purchase approximately \$2.3 million of inventory, operating assets and other supplies, which are expected to occur primarily during the first and second quarters of our fiscal year ending March 31, 2014.

**10. Stockholders Equity****Preferred Stock**

Our certificate of incorporation provides for the issuance of up to 2,000,000 shares of preferred stock. Our Board of Directors is authorized to issue from time to time such authorized but unissued shares of preferred stock in one or more series and to fix or alter the designations, preferences, rights and any qualifications, limitations or restrictions of the shares of each such series, including the dividend, conversion, voting, redemption and liquidation rights. As of March 31, 2013 and 2012, there were no outstanding shares of preferred stock, and we do not currently have plans to issue any shares of preferred stock.

In August 2009, our Board of Directors adopted a stockholder rights plan, which calls for preferred stock purchase rights (each, a Right ) to be distributed, as a dividend, at the rate of one Right for each share of common stock held as of September 3, 2009. Each Right will entitle holders of common stock to buy one one-thousandth of one share of Series A Junior Participating Preferred Stock of Iteris. A further description and terms of the Rights are set forth in the Rights Agreement dated August 20, 2009 by and between Iteris and Computershare Trust Company, N.A., as rights agent. In connection with the stockholder rights plan, our Board of Directors approved the adoption of a Certificate of Designations, which created the Series A Junior Participating Preferred Stock, and likewise authorized the filing of a Certification of Elimination to eliminate the two series of junior participating preferred stock, which were originally created in April 1998 in connection with our previous stockholder rights plan which expired in 2008.

Table of Contents**Common Stock Warrants**

As of March 31, 2013, we had outstanding fully exercisable warrants to purchase 15,000 shares of our common stock. These warrants have an exercise price per share of \$1.42 and a remaining contractual life of 0.4 years. There was no activity with respect to these or any other warrants during Fiscal 2013.

In connection with our adoption of certain provisions of accounting for derivatives, which became effective for us on April 1, 2009, we determined that certain outstanding warrants to purchase shares of our common stock contained provisions that provide for a possible future adjustment to either the exercise price and/or number of shares to be issued upon exercise. As such, beginning April 1, 2009, we began recognizing these warrants as liabilities at their respective estimated fair values on each reporting date. The cumulative effect of the change in accounting for these warrants of \$47,000 was recognized as an adjustment to the opening balance of accumulated deficit at April 1, 2009. The amounts recognized in the consolidated balance sheet as a result of our adoption on April 1, 2009 were determined based on the amounts that would have been recognized if this accounting treatment had been applied from the issuance date of the warrants. By March 31, 2011, all such warrants had expired unexercised, and thus there was no remaining liability recorded on our consolidated balance sheet at that date or thereafter. We estimated the fair value of these warrants using the BSM option-pricing formula. The change in the estimated fair value of the warrants for the fiscal year ended March 31, 2011 is included in other income, net in the accompanying consolidated statement of operations.

**Common Stock Reserved for Future Issuance**

The following summarizes common stock reserved for future issuance at March 31, 2013:

	<b>Number of Shares (In thousands)</b>
Stock options outstanding	1,744
Restricted stock units outstanding	210
Authorized for future issuance under stock incentive plans	921
Warrants outstanding	15
	<b>2,890</b>

**11. Employee Benefit Plans****Stock Incentive Plans**

In September 2007, our stockholders approved the 2007 Omnibus Incentive Plan (the 2007 Plan), which provides that options to purchase shares of our unissued common stock may be granted to our employees, officers, consultants and directors at exercise prices which are equal to or greater than the market value of our common stock on the date of grant. Options expire no more than ten years after the date of grant and generally vest at the rate of 25% on each of the first four anniversaries of the grant date. The 2007 Plan also allows for the issuance of stock appreciation rights, restricted stock, restricted stock units (RSUs) and other stock-based awards based on the value of our common stock. New

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shares are issued to satisfy stock option exercises and share issuances under the 2007 Plan. In September 2009, our stockholders approved an amendment to increase the number of shares of our common stock authorized and reserved for issuance under the 2007 Plan by 800,000 shares to a total of 1,650,000 shares. In September 2012, our stockholders approved an amendment to increase the number of shares of our common stock authorized and reserved for issuance under the 2007 Plan by 800,000 shares to a total of 2,450,000 shares. At March 31, 2013, there were approximately 921,000 shares of common stock available for grant under this plan. As of March 31, 2013, options to purchase approximately 1,186,000 shares of common stock, as well as 210,000 RSUs, were outstanding under the 2007 Plan.

Our 1997 Stock Incentive Plan (the 1997 Plan ) terminated in September 2007; however, all stock options outstanding under the 1997 Plan remain outstanding pursuant to the terms of such stock options. As of March 31, 2013, options to purchase approximately 558,000 shares of our common stock were outstanding under the 1997 Plan. No further options or other stock-based awards may be granted under the 1997 Plan.

In connection with our merger with our Iteris, Inc. subsidiary (the Iteris Subsidiary ) in 2004, we assumed the 1998 Stock Incentive Plan (the 1998 Plan ) of the Iteris Subsidiary and all outstanding options granted thereunder. As of March 31, 2013, there were no options remaining to purchase shares of our common stock under the 1998 Plan. No further options or other stock-based awards may be granted under the 1998 Plan.

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Certain options granted under the 2007 Plan and the 1997 Plan (collectively, the Plans ) and the RSUs granted under the 2007 Plan provide for accelerated vesting of unvested options in the event of a change in control under certain circumstances.

**Stock Options**

A summary of activity in the Plans with respect to our stock options for Fiscal 2013 is as follows:

	Number of Options (In thousands)	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (In thousands)
Options outstanding at March 31, 2012	2,493	\$ 1.64		
Granted	220	1.53		
Exercised	(189)	1.33		
Forfeited	(49)	1.14		
Expired	(731)	1.46		
Options outstanding at March 31, 2013	1,744	\$ 1.74	5.2	\$ 626
Options exercisable at March 31, 2013	1,288	\$ 1.87	4.0	\$ 423
Vested and expected to vest at March 31, 2013	1,690	\$ 1.75	5.1	\$ 601
Options exercisable at March 31, 2013 pursuant to a change-in-control	1,744	\$ 1.74	5.2	\$ 626

**Restricted Stock Units**

In August 2010, we began granting RSUs under the 2007 Plan to certain of our employees. RSU awards are stock-based awards that entitle the holder to receive one share of our common stock for each RSU upon vesting. RSUs vest at the rate of 25% on each of the first four anniversaries of the grant date provided that the holder remains in service (as defined by the 2007 Plan) as of the vesting date. The fair value per RSU is determined based on the closing market price of our common stock on the grant date.

A summary of activity with respect to our RSUs for Fiscal 2013 is as follows:

	Number of Shares (In thousands)	Weighted Average Price Per Share	Weighted Average Remaining Life (Years)	Aggregate Intrinsic Value (In thousands)
RSUs outstanding at March 31, 2012	235	\$ 1.32		

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Granted	80		1.50		
Vested	(68)		1.35		
Forfeited	(37)		1.23		
RSUs outstanding at March 31, 2013	210	\$	1.39	2.4	\$ 56
Expected to vest at March 31, 2013	182	\$	1.39	2.3	\$ 49
Common stock issuable (for RSUs) at March 31, 2013 upon a change-in-control	210	\$	1.39	2.4	\$ 56

**Stock-Based Compensation**

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

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	2013	Year Ended March 31, 2012		2011
		(In thousands)		
Cost of revenues	\$ 42	\$ 45	\$ 47	
Selling, general and administrative expense	237	280	305	
Income from discontinued operation, net of tax		6	30	
Total stock-based compensation	\$ 279	\$ 331	\$ 382	

At March 31, 2013, there was approximately \$419,000 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 2.2 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.

The grant date fair value of stock options granted was estimated using the following weighted-average assumptions:

	2013	Year Ended March 31, 2012		2011
Expected life - years	7.0	7.0	7.0	
Risk-free interest rate	1.2%	1.6%	2.1%	
Expected volatility of common stock	52%	52%	58%	
Dividend yield	%	%	%	

A summary of certain fair value and intrinsic value information pertaining to our stock options is as follows:

	2013	Year Ended March 31, 2012		2011
	(In thousands, except per share amounts)			
Weighted average grant date fair value per share of options granted	\$ 0.81	\$ 0.61	\$ 0.86	
Intrinsic value of options exercised	\$ 42	\$ 7	\$ 23	

**Employee Incentive Programs**

Under the terms of a Profit Sharing Plan, we may contribute to a trust fund such amounts as determined annually by the Board of Directors. No contributions were made during the fiscal years ended March 31, 2013, 2012 and 2011.

We sponsor a defined contribution 401(k) plan ( the 401(k) Plan ), adopted in 1990, under which eligible associates voluntarily contribute to the plan, up to IRS maximums, through payroll deductions. Under the provisions of the 401(k) Plan, associates have various investment choices, one of which is the purchase of Iteris common stock at market price. We match up to 90% of contributions, based on years of service, up to a stated



limit. From July 1, 2009 through March 31, 2010, we temporarily suspended our matching contributions to the 401(k) Plan. Beginning in April 2010, we reinstated certain limited matching contributions to the 401(k) Plan. Our matching contributions under the 401(k) Plan were approximately \$498,000, \$475,000 and \$491,000 for the fiscal years ended March 31, 2013, 2012 and 2011, respectively.

**12. Stock Repurchase Program**

In August 2011, our Board of Directors approved a stock repurchase program pursuant to which we were authorized to acquire up to \$3 million of our outstanding common stock from time to time through August 2012. On August 9, 2012, our Board of Directors approved a new stock repurchase program pursuant to which we may acquire up to \$3 million of our outstanding common stock for an unspecified length of time. Under the new program, we may repurchase shares from time to time in open-market and privately negotiated transactions and block trades, and may also repurchase shares pursuant to a 10b5-1 trading plan during our closed trading windows. There is no guarantee as to the exact number of shares that will be repurchased. We may modify or terminate the repurchase program at any time without prior notice. From inception of the program in August 2011 through March 31, 2013, we repurchased approximately 2,097,000 shares of our common stock for an aggregate of approximately \$3.2 million at an average price per share of \$1.52.

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For our fiscal year ended March 31, 2013 and 2012, we repurchased approximately 1,523,000 and 574,000 shares of our common stock, respectively. All repurchased shares have been retired and resumed their status as authorized and unissued shares of our common stock as of March 31, 2013.

**13. Business Segments, Significant Customer and Geographic Information**

**Business Segments**

We 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 includes the operations of MET, which specializes in 511 advanced traveler information systems and offers Maintenance Decision Support System management tools that allow users to create solutions to meet roadway maintenance decision needs.

The iPerform segment includes our performance measurement and information management solutions, including all the operations of BTS, which specializes in transportation performance measurement. During Fiscal 2012, we began the development of IterisPeMS. IterisPeMS 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 predictive traffic analytics and easy-to-use visualization and animation features based on historical traffic conditions.

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 reported segment revenues are derived from external customers.

Selected financial information for our reportable segments for the fiscal years ended March 31, 2013, 2012 and 2011 is as follows:

**iPerform**

**Total**

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	Roadway Sensors	Transportation Systems	(In thousands)	
<b>Year Ended March 31, 2013</b>				
Revenues	\$ 26,002	\$ 32,389	\$ 3,294	\$ 61,685
Depreciation	221	362	20	603
Segment income (loss)	4,119	3,622	(294)	7,447
<b>Year Ended March 31, 2012</b>				
Revenues	\$ 27,679	\$ 29,792	\$ 935	\$ 58,406
Depreciation	194	393	5	592
Segment income (loss)	4,813	3,151	(367)	7,597
<b>Year Ended March 31, 2011</b>				
Revenues	\$ 28,208	\$ 23,758	\$	\$ 51,966
Depreciation	217	250		467
Impairment of goodwill		7,970		7,970
Segment income (loss)	6,328	(5,258)		1,070

The following table reconciles total segment income to consolidated income (loss) from continuing operations before income taxes:

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	Year Ended March 31,		
	2013	2012	2011
<b>Segment income (loss):</b>			
Total income from reportable segments	\$ 7,447	\$ 7,597	\$ 1,070
<b>Unallocated amounts:</b>			
Corporate and other expenses	(5,350)	(5,695)	(5,581)
Amortization of intangible assets	(644)	(504)	(176)
Change in fair value of contingent acquisition consideration	181	619	(55)
Other income, net	2	4	18
Interest expense, net	(6)	(72)	(152)
Income (loss) from continuing operations before income taxes	\$ 1,630	\$ 1,949	\$ (4,876)

**Significant Customer and Geographic Information**

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 Fiscal 2011, no individual customer represented greater than 10% of our total revenues.

No individual customer or government agency had a receivable balance at March 31, 2013 or 2012 greater than 10% of our total trade accounts receivable balances as of March 31, 2013 and 2012, respectively.

The following table sets forth the percentages of our revenues, by geographic region, derived from shipments to, or contract, service and other revenues from, external customers located outside the U.S.:

	Year Ended March 31,		
	2013	2012	2011
Middle East	3%	%	%
Europe			5
Asia		1	5
Other	1	1	3
	4%	2%	13%

Substantially all of our long-lived assets are held in the U.S.

**14. Quarterly Financial Data (Unaudited)**

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Quarter Ended:	Revenues	Gross Profit	Net Income	Basic Net Income per Share	Diluted Net Income per Share
	(In thousands, except per share amounts)				
June 30, 2012	\$ 16,304	\$ 6,264	\$ 676	\$ 0.02	\$ 0.02
September 30, 2012	15,504	6,071	550	0.02	0.02
December 31, 2012	13,994	5,151	1,097	0.03	0.03
March 31, 2013	15,883	5,772	56	0.00	0.00
	\$ 61,685	\$ 23,258	\$ 2,379	\$ 0.07*	\$ 0.07*
June 30, 2011	\$ 13,892	\$ 5,869	\$ 97	\$ 0.00	\$ 0.00
September 30, 2011	14,393	6,005	1,310	0.04	0.04
December 31, 2011	14,881	5,464	747	0.02	0.02
March 31, 2012	15,240	5,733	360	0.01	0.01
	\$ 58,406	\$ 23,071	\$ 2,514	\$ 0.07*	\$ 0.07*

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\* Annual per share amounts may not agree to the sum of the quarterly per share amounts due to differences between average shares outstanding during the periods.

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Exhibit Number	Description	Reference
2.1+	Stock Purchase Agreement dated December 23, 2010 by and among Iteris, Inc., Meridian Environmental Technology, Inc., ( MET ) the shareholders of MET and Kathy J. Osborne as the Shareholders Representative	<i>Exhibit 2.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010 as filed with the SEC on February 14, 2011</i>
2.2+	Asset Purchase Agreement by and between Iteris, Inc. and Bendix Commercial Vehicle Systems LLC, dated as of July 25, 2011	<i>Exhibit 2.1 to the registrant's Current Report on Form 8-K/A as filed with the SEC on November 1, 2011</i>
3.1	Restated Certificate of Incorporation of the registrant	<i>Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 as filed with the SEC on October 30, 2009</i>
3.2	Certificate of Designations of Series A Junior Participating Preferred Stock	<i>Exhibit 3.2 to the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 as filed with the SEC on October 30, 2009</i>
3.3	Bylaws of the registrant, as amended	<i>Exhibit 4.2 to the registrant's Registration Statement on Form S-1 (Reg. No. 033-67932) as filed with the SEC on July 6, 1993</i>
3.4	Certificates of Amendment to Bylaws of the registrant dated April 24, 1998 and August 10, 2001	<i>Exhibit 3.4 to the registrant's Annual Report on Form 10-K/A for the year ended March 31, 2003 as filed with the SEC on July 29, 2003</i>
3.5	Certificate of Amendment to Bylaws of registrant dated September 9, 2004	<i>Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 as filed with the SEC on November 15, 2004</i>
3.6	Certificate of Amendment to Bylaws of registrant effective September 16, 2005	<i>Exhibit 3.5 to the registrant's Annual Report on Form 10-K for the year ended March 31, 2007</i>
3.7	Certificate of Amendment to Bylaws of registrant effective December 7, 2007	<i>Exhibit 3.1 to the registrant's Current Report on Form 8-K as filed with the SEC on December 13, 2007</i>
3.8	Certificate of Amendment to Bylaws of registrant, effective August 20, 2009	<i>Exhibit 3.3 to the registrant's Current Report on Form 8-K as filed with the SEC on August 21, 2009</i>
4.1	Specimen of common stock certificate	<i>Exhibit 4.1 to registrant's Registration Statement on Form 8-A as filed with the SEC on December 8, 2004</i>
4.2	Rights Agreement dated August 20, 2009 between the registrant and Computershare Trust Company, N.A., which includes the form of Certificate of Designations for the Series A Junior Participating Preferred Stock, the form of Right Certificate, and Summary of Rights to Purchase Preferred Stock as exhibits thereto	<i>Exhibit 4.1 to the registrant's Current Report on Form 8-K as filed with the SEC on August 21, 2009</i>
10.1		

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Form of Indemnity Agreement entered into by the registrant and certain of its officers and directors

*Exhibit 19.4 to the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1988*

10.2

Form of Indemnification Agreement entered into by the registrant and certain of its officers and directors

*Exhibit 10.5 to the registrant's Annual Report on Form 10-K for the year ended March 31, 2004 as filed with the SEC on June 29, 2004*



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10.3*	1997 Stock Incentive Plan (the 1997 Plan ) as amended on May 3, 2003, as further amended on December 15, 2004	<i>Exhibit 10.32 to the registrant s Annual Report on Form 10-K for the year ended March 31, 2005 as filed with the SEC on July 14, 2005</i>
10.4*	Form of Notice of Grant of Stock Option for 1997 Plan	<i>Exhibit 99.2 to the registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000</i>
10.5*	Form of Stock Option Agreement for the 1997 Plan	<i>Exhibit 99.3 to the registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000</i>
10.6*	Form of Addendum to Stock Option Agreement for 1997 Plan Involuntary Termination Following Corporate Transaction or Change in Control	<i>Exhibit 99.4 to the registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000</i>
10.7*	Form of Addendum to Stock Option Agreement for 1997 Plan Limited Stock Appreciation Rights	<i>Exhibit 99.5 to the registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000</i>
10.8*	Form of Stock Issuance Agreement for 1997 Plan	<i>Exhibit 99.6 to the registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000</i>
10.9*	Form of Addendum to Stock Issuance Agreement for 1997 Plan Involuntary Termination Following Corporate Transaction/Change in Control	<i>Exhibit 99.7 to the registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000</i>
10.10*	Form of Notice of Grant of Automatic Stock Option for 1997 Plan Initial Grant	<i>Exhibit 99.8 to Exhibit 99.8 to registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000</i>
10.11*	Form of Notice of Grant of Automatic Stock Option for 1997 Plan Annual Grant	<i>Exhibit 99.9 to the registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000</i>
10.12*	Form of Automatic Stock Option Agreement for 1997 Plan	<i>Exhibit 99.10 to the registrant s Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 19, 2000</i>
10.13*	Iteris Inc. 1998 Stock Incentive Plan (as amended on February 7, 2000) ( 1998 Plan )	<i>Exhibit 10.24 to the registrant s Annual Report on Form 10-K for the year ended March 31, 2005 as filed with the SEC on July 14, 2005</i>
10.14*	Form of Notice of Grant for 1998 Plan, including forms of Option Agreement and Stock Purchase Agreement for the following directors and executive officers: Gregory McKhann, James S. Miele and Abbas Mohaddes	<i>Exhibit 99.2 to the registrant s Registration Statement on Form S-8 (File No. 333-126834) as filed with the SEC on July 22, 2005</i>
10.15*	Form of Addendum to Stock Option Agreement for 1998 Plan	<i>Exhibit 99.3 to the registrant s Registration Statement on Form S-8 (File No. 333-126834) as filed with the SEC on July 22, 2005</i>
10.16*	Form of 1997 Stock Option Agreements	<i>Exhibit 99.4 to the registrant s Registration Statement on Form S-8 (File No. 333-126834) as filed with the SEC on July 22, 2005</i>



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10.17	Sublease Agreement, dated September 30, 2003, by and between Odetics, Inc. and Maij, Inc.	<i>Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 as filed with the SEC on August 14, 2007</i>
10.18	Office Lease Agreement, dated May 24, 2007, by and between Crown Carnegie Associates, LLC and Iteris, Inc.	<i>Exhibit 10.2 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 as filed with the SEC on August 14, 2007</i>
10.19*	2007 Omnibus Incentive Plan	<i>Exhibit 10.19 to the registrant's Annual Report on Form 10-K for the year ended March 31, 2012 as filed with the SEC on June 11, 2012</i>
10.20*	Forms of Stock Option Agreements under the 2007 Omnibus Incentive Plan	<i>Exhibit 10.20 to the registrant's Annual Report on Form 10-K for the year ended March 31, 2012 as filed with the SEC on June 11, 2012</i>
10.21*	Change in Control Agreement dated June 11, 2008 by and between James S. Miele and Iteris, Inc.	<i>Exhibit 10.42 to the registrant's Annual Report on Form 10-K for the year ended March 31, 2008 as filed with the SEC on June 12, 2008</i>
10.22	Amended and Restated Loan and Security Agreement dated February 4, 2009 by and between California Bank & Trust and the registrant	<i>Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 as filed with the SEC on February 13, 2009</i>
10.23	Unsecured Promissory Note dated August 10, 2009 executed by MAXxess Systems, Inc.	<i>Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 as filed with the SEC on August 11, 2009</i>
10.24*	Letter Agreement dated July 27, 2010 by and between the registrant and Abbas Mohaddes	<i>Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010 as filed with the SEC on July 28, 2010</i>
10.25*	Change in Control Agreement dated July 27, 2010 by and between the registrant and Abbas Mohaddes	<i>Exhibit 10.2 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010 as filed with the SEC on July 28, 2010</i>
10.26*	Form of Restricted Stock Unit Award Agreement under the 2007 Omnibus Incentive Plan	<i>Exhibit 10.3 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010 as filed with the SEC on July 28, 2010</i>
10.27	Modification Agreement dated September 30, 2010 by and between Iteris, Inc. and California Bank & Trust	<i>Exhibit 10.1 to the registrant's Current Report on Form 8-K as filed with the SEC on October 6, 2010</i>
21	Subsidiaries of the registrant	<i>Filed herewith</i>
23	Consent of Independent Registered Public Accounting Firm	<i>Filed herewith</i>
24	Power of Attorney	<i>Filed herewith (included on the Signature page)</i>
31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>
31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>

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32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *Filed herewith*

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32.2	Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	<i>Filed herewith</i>
101.INS#	XBRL Instance Document	<i>Filed herewith</i>
101.SCH#	XBRL Taxonomy Extension Schema Document	<i>Filed herewith</i>
101.CAL#	XBRL Taxonomy Extension Calculation Linkbase Document	<i>Filed herewith</i>
101.LAB#	XBRL Taxonomy Extension Label Linkbase Document	<i>Filed herewith</i>
101.PRE#	XBRL Taxonomy Extension Presentation Linkbase Document	<i>Filed herewith</i>
101.DEF#	XBRL Taxonomy Definition Presentation Linkbase Document	<i>Filed herewith</i>

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\* Indicates a management contract or compensatory plan or arrangement

+ Confidential treatment has been requested for certain confidential portions of this exhibit pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended. In accordance with Rule 24b-2, these confidential portions have been omitted from the exhibit and filed separately with the SEC.

# Pursuant to Rule 406T of Regulation S-T, these interactive data files i) are not deemed filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, irrespective of any general incorporation language included in any such filings, and otherwise are not subject to liability under these sections; and ii) are deemed to have complied with Rule 405 of Regulation S-T ( Rule 405 ) and are not subject to liability under the anti-fraud provisions of the Section 17(a)(1) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 or under any other liability provision if we have made a good faith attempt to comply with Rule 405 and, after we become aware that the interactive data files fail to comply with Rule 405, we promptly amend the interactive data files.