ITERIS, INC.
Form 10-Q
February 02, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2009

OR

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

For the transition period from to

Commission file number: 001-08762

ITERIS, INC.

(Exact name of registrant as specified in its charter)

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

(949) 270-9400

(Registrant s telephone number, including area code)

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

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

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

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

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

As of January 29, 2010, there were 34,286,756 shares of common stock outstanding.

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ITERIS, INC.

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For the Three and Nine Months Ended December 31, 2009

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

AutoVue®, Iteris®, Vantage®, VersiCam , EdgeConnect , RZ4 Advanced , Pico and Safety Direct are among the trademarks of Iteris, Inc. Any other trademarks or trade names mentioned herein are the property of their respective owners.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Iteris, Inc.

Unaudited Condensed Consolidated Balance Sheets

(In thousands, except par value)

	December 31, 2009	March 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 9,404	$ 6,372
Trade accounts receivable	10,010	12,448
Costs in excess of billings on uncompleted contracts	4,780	4,217
Inventories	3,203	5,681
Deferred income taxes	3,667	4,241
Prepaid expenses and other current assets	473	272
Total current assets	31,537	33,231
Property and equipment, net	2,685	3,244
Deferred income taxes	11,505	11,505
Intangible assets, net	489	110
Goodwill	27,791	27,774
Other assets	198	202
Total assets	$ 74,205	$ 76,066
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	$ 3,119	$ 4,228
Accrued payroll and related expenses	2,243	3,188
Accrued liabilities	1,853	1,662
Billings in excess of costs and estimated earnings on uncompleted contracts	1,729	1,534
Current portion of long-term debt	2,324	2,019
Total current liabilities	11,268	12,631
Deferred rent	1,464	1,686
Unrecognized tax benefits	794	1,117
Other non-current liabilities	112	
Long-term debt	3,426	5,274
Total liabilities	17,064	20,708
Commitments and contingencies		
Stockholders' equity:		
Common stock. $0.10 par value, 70,000 shares authorized, 34,281 and 34,205 shares issued and outstanding at December 31, 2009 and March 31, 2009, respectively	3,428	3,420
Additional paid-in capital	137,361	136,997
Common stock held in trust		(31)
Accumulated deficit	(83,676)	(85,025)
Accumulated other comprehensive income (loss)	28	(3)
Total stockholders' equity	57,141	55,358
Total liabilities and stockholders' equity	$ 74,205	$ 76,066

See accompanying notes.

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Iteris, Inc.

Unaudited Condensed Consolidated Statements of Operations

(In thousands, except per share amounts)

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008	Nine Months Ended December 31, 2009	Nine Months Ended December 31, 2008
Net sales and contract revenues:				
Net sales	$ 7,401	$ 9,083	$ 22,796	$ 30,687
Contract revenues	6,176	7,379	20,280	22,283
Total net sales and contract revenues	13,577	16,462	43,076	52,970
Costs of net sales and contract revenues:				
Cost of net sales(a)	3,844	4,890	12,099	16,043
Cost of contract revenues(a)	4,198	5,068	13,290	14,796
Gross profit	5,535	6,504	17,687	22,131
Operating expenses:				
Selling, general and administrative(a)	3,915	4,385	12,695	14,193
Research and development(a)	890	848	2,738	3,180
Amortization of intangible assets	36	37	122	110
Total operating expenses	4,841	5,270	15,555	17,483
Operating income	694	1,234	2,132	4,648
Non-operating income (expense):				
Other income, net	25	63	42	90
Interest expense, net	(58)	(141)	(215)	(537)
Income before income taxes	661	1,156	1,959	4,201
Benefit (provision) for income taxes	48	(415)	(563)	(1,727)
Net income	$ 709	$ 741	$ 1,396	$ 2,474
Earnings per share:				
Basic	$ 0.02	$ 0.02	$ 0.04	$ 0.07
Diluted	$ 0.02	$ 0.02	$ 0.04	$ 0.07
Weighted average shares outstanding:				
Basic	34,260	34,120	34,235	33,895
Diluted	34,469	34,358	34,430	34,752

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

Cost of net sales	$ 3	$ 2	$ 7	$ 7
Cost of contract revenues	10	10	30	30
Selling, general and administrative expense	75	75	225	228
Research and development expense	7	5	20	15
Total stock-based compensation expense	$ 95	$ 92	$ 282	$ 280

See accompanying notes.

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Iteris, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(In thousands)

	Nine Months Ended December 31, 2009		2008	
Cash flows from operating activities				
Net income	$	1,396	$	2,474
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation of property and equipment		742		755
Stock-based compensation		282		280
Amortization of intangible assets		122		110
Amortization of debt discounts				166
Amortization of deferred financing costs				110
Change in deferred tax assets		574		1,700
Changes in operating assets and liabilities:				
Accounts receivable		2,451		258
Net costs and estimated earnings in excess of billings		(368)		2,646
Inventories		2,478		(771)
Prepaid expenses and other assets		(196)		80
Accounts payable and accrued expenses		(2,569)		(1,778)
Net cash provided by operating activities		4,912		6,030
Cash flows from investing activities				
Purchases of property and equipment		(180)		(716)
Cash paid for business combination		(300)		
Net cash used in investing activities		(480)		(716)
Cash flows from financing activities				
Borrowings on long-term debt		750		5,073
Payments on long-term debt		(2,293)		(5,744)
Proceeds from stock option exercises		90		911
Net cash provided by (used in) financing activities		(1,453)		240
Effect of exchange rate changes on cash		53		
Increase in cash and cash equivalents		3,032		5,554
Cash and cash equivalents at beginning of period		6,372		421
Cash and cash equivalents at end of period	$	9,404	$	5,975
Supplemental disclosure of non-cash investing and financing activities:				
Liabilities incurred for business combination	$	218	$	
Fair value of common stock issued in settlement of liabilities				427

See accompanying notes.

Iteris, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

December 31, 2009

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Iteris, Inc. (including our subsidiary, referred to collectively in these consolidated financial statements as Iteris, the Company, we, our and us a leader in the traffic management market focused on the development and application of advanced technologies that reduce traffic congestion, minimize the environmental impact of traffic congestion and improve the safety of surface transportation systems infrastructure. By combining outdoor image processing, traffic engineering and information technology, we offer a broad range of Intelligent Transportation Systems (ITS) and driver safety solutions. Iteris was originally incorporated in Delaware in 1987.

Basis of Presentation

Our unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and with the instructions to Securities and Exchange Commission (SEC) Form 10-Q and Article 10 of SEC Regulation S-X. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position of Iteris as of December 31, 2009, the consolidated results of operations for the three and nine months ended December 31, 2009 and 2008 and the consolidated cash flows for the nine months ended December 31, 2009 and 2008. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. The results of operations for the three and nine months ended December 31, 2009 are not necessarily indicative of those to be expected for future quarterly periods or the entire fiscal year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended March 31, 2009 (fiscal 2009), which was filed with the SEC on June 12, 2009. We have evaluated subsequent events through February 2, 2010, which represents the date these financial statements were issued.

Use of Estimates

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

Revenue Recognition

Product revenues and related costs of sales are recognized upon the transfer of title, which generally occurs upon shipment or, if required, upon acceptance by the customer, provided that we believe collectibility of the net sales amount is probable. Accordingly, at the date revenue is recognized, the significant uncertainties concerning the sale have been resolved.

Contract revenues are derived primarily from long-term contracts with governmental agencies. Contract revenues include costs incurred plus a portion of estimated fees or profits determined on the percentage of completion method of accounting based on the relationship of costs incurred to date to total estimated costs. Any anticipated losses on contracts are charged to earnings when identified. Changes in job performance and estimated profitability, including those arising from contract penalty provisions and final contract settlements, may result in revisions to costs and revenues and are recognized in the period in which the revisions are determined. Profit incentives are included in revenue when their realization is reasonably assured.

We also derive revenue from the provision of specific non-recurring contract engineering services and royalties. Non-recurring contract engineering revenues are recognized in the period in which the related services are performed. Royalty revenues are recorded in the period in which the royalty is earned based on unit sales of certain of our products. Non-recurring contract engineering and royalty revenues are included in net sales in the accompanying unaudited condensed consolidated statements of operations and totaled $124,000 and $563,000 for the three and nine months ended December 31, 2009, respectively, and $315,000 and $973,000 for the three and nine months ended December 31, 2008, respectively.

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Concentration of Credit Risk

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

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

Accounts receivable are primarily derived from revenues earned from customers located throughout North America and Europe. We generally do not require collateral or other security from customers. Collectibility of receivable balances is estimated through review of invoices outstanding greater than a certain period of time and ongoing credit evaluations of our customers financial condition. Reserves are maintained for potential credit losses, and such losses have historically been within management s expectations.

Fair Values of Financial Instruments

The fair 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, long-term debt and convertible debentures 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. The estimated fair value of certain of our outstanding warrants is determined using Level 3 inputs (see Notes 7 and 8).

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Property and Equipment

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

Goodwill and Long-Lived Assets

Goodwill is tested for impairment on an annual basis in our fourth fiscal quarter or more frequently if indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of our reporting units with each respective reporting unit s carrying amount, including goodwill. We determine the fair value of reporting units using the income approach. If the carrying amount of a reporting unit exceeds the reporting unit s fair value, the second step of the goodwill impairment test is performed to determine the amount of any impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. We performed annual impairment assessments of the carrying value of goodwill for each of the fiscal years ended March 31, 2009, 2008 and 2007. 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 of our reporting units would cause us to test goodwill for impairment. No such events occurred during the three and nine months ended December 31, 2009.

We evaluate long-lived assets for impairment when indicators of impairment are present. Reviews are performed to determine whether the carrying value of assets is impaired, based on a comparison to undiscounted expected future cash flows. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using discounted expected future cash flows and a discount rate based upon our weighted average cost of capital adjusted for risks associated with the related operations. Impairment is based on the excess of the carrying amount over the fair value of those assets.

Income Taxes

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

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Stock-Based Compensation

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

Research and Development Expenditures

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

Shipping and Handling Costs

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

Sales Taxes

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

Warranty

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

Repair and Maintenance Costs

We incur repair and maintenance costs in the normal course of business. Should the activity result in a permanent improvement to 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.

Other Comprehensive Income

The only component of accumulated other comprehensive income is foreign currency translation adjustments.

Recent Accounting Pronouncements

In August 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-05, *Measuring Liabilities at Fair Value* (ASU 2009-05). ASU 2009-05 amends Topic 820 of the FASB Accounting Standards Codification (ASC) by providing additional guidance clarifying the measurement of liabilities at fair value. The adoption of the amendments prescribed by ASU 2009-05 were effective for our fiscal quarter ended December 31, 2009 and did not have a material impact on our consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-13, *Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force* (ASU 2009-13), which amends the existing multiple-element revenue arrangements guidance currently included in ASC 605-25, *Revenue Recognition Multiple Element Arrangements*. ASU 2009-13 provides for two significant changes to the existing multiple-element revenue arrangements guidance. The first relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables. We plan to adopt the amendments prescribed by ASU 2009-13 for our fiscal year beginning April 1, 2010. We do not expect that the adoption of this ASU will have a material impact on our consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-14, *Certain Revenue Arrangements That Include Software Elements a consensus of the FASB Emerging Issues Task Force* (ASU 2009-14), which amends and modifies the scope of ASC 985-605, *Software Revenue Recognition*, such that many tangible products that rely on software and other related transactions will fall outside its scope. We plan to adopt the amendments prescribed by ASU 2009-14 for our fiscal year beginning April 1, 2010. We do not expect that the adoption of this ASU will have a material impact on our consolidated financial statements.

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In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06), which amends ASC Topic 820, *Fair Value Measurements and Disclosures* (ASC 820) to require various additional disclosures regarding fair value measurements and also clarify certain existing disclosure requirements. Additional requirements include disclosing (i) the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy, (ii) the reasons for any transfers in or out of Level 3 and (iii) information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. ASU 2010-06 does not change any accounting requirements, but is expected to have a significant effect on the disclosures of entities that measure assets and liabilities at fair value. The amendments prescribed by ASU 2010-06 will be effective for our fiscal quarter ending March 31, 2010, except for the requirements described in item (iii) above, which will be effective for our fiscal year beginning April 1, 2011. We currently do not expect the adoption of this ASU will have a material impact on our consolidated financial statements.

2. Supplemental Financial Information

Inventories

The following table presents details of our inventories:

	December 31, 2009	March 31, 2009
	(In thousands)	
Materials and supplies	$ 2,571	$ 4,820
Work in process	93	198
Finished goods	539	663
	$ 3,203	$ 5,681

Intangible Assets

The following table presents details of our intangible assets:

	December 31, 2009		March 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Intangible assets subject to amortization:				
Developed technology	$ 996	$ (570)	$ 495	$ (482)
Patents	317	(254)	317	(220)
Total	$ 1,313	$ (824)	$ 812	$ (702)

As of December 31, 2009, future estimated amortization expense is as follows:

Fiscal Year Ending March 31: **(In thousands)**		
Remainder of 2010	$	37
2011		152
2012		100
2013		100
2014		100
	$	489

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Goodwill

The following table presents the activity related to the carrying value of our goodwill by reportable segment for the nine months ended December 31, 2009:

	Roadway Sensors	Vehicle Sensors	Transportation Systems	Total
		(In thousands)		
Beginning balance	$ 8,197	$ 4,671	$ 14,906	$ 27,774
Goodwill recorded in connection with Hamilton Signal acquisition (Note 3)	17			17
Ending balance	$ 8,214	$ 4,671	$ 14,906	$ 27,791

Warranty Reserve Activity

The following table presents activity related to the warranty reserve:

	Nine Months Ended December 31, 2009	2008
	(In thousands)	
Balance at beginning of period	$ 582	$ 494
Additions charged to cost of sales	102	258
Warranty claims	(141)	(196)
Balance at end of period	$ 543	$ 556

Comprehensive Income

The following table presents the components of comprehensive income:

	Three Months Ended December 31, 2009	2008	Nine Months Ended December 31, 2009	2008
		(In thousands)		
Net income	$ 709	$ 741	$ 1,396	$ 2,474
Other comprehensive income (loss):				
Foreign currency translation adjustments	(5)	(3)	31	(31)
Total comprehensive income	$ 704	$ 738	$ 1,427	$ 2,443

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Earnings Per Share

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

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008	Nine Months Ended December 31, 2009	Nine Months Ended December 31, 2008
	(In thousands, except per share amounts)			
Numerator:				
Net Income	$ 709	$ 741	$ 1,396	$ 2,474
Denominator:				
Weighted average common shares used in basic computation	34,260	34,120	34,235	33,895
Dilutive stock options	208	238	194	853
Dilutive warrants	1		1	4
Weighted average common shares used in diluted computation	34,469	34,358	34,430	34,752
Earnings per share:				
Basic	$ 0.02	$ 0.02	$ 0.04	$ 0.07
Diluted	$ 0.02	$ 0.02	$ 0.04	$ 0.07

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

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008	Nine Months Ended December 31, 2009	Nine Months Ended December 31, 2008
	(In thousands)			
Stock options	1,095	2,184	2,043	1,245
Warrants	335	1,165	387	1,155
Convertible debentures		623		1,639

3. Business Combination

On April 3, 2009 (the Closing), we completed the acquisition of certain assets of Hamilton Signal, Inc., a privately-held developer of video processing algorithms enabling state and local governments to conduct real-time analysis on fixed and Pan-Tilt-Zoom camera feeds. The total purchase consideration was approximately $518,000, for which we paid $300,000 in cash upon execution of the purchase agreement, and for which, pursuant to the purchase agreement, we are scheduled to pay an additional (i) $106,000 on the first anniversary of the Closing and (ii) approximately $112,000 on the second anniversary of the Closing. Pursuant to the purchase agreement, the seller became an employee of Iteris and is eligible to receive compensation based on future net sales of certain products during the three-year period ending March 31, 2012, subject to continued employment and other limitations.

We have accounted for this acquisition as a business combination. We calculated the fair value of the assets acquired to allocate the purchase price, which is summarized as follows (in thousands):

Developed technology	$	501
Goodwill		17
	$	518

The purchased developed technology was determined to have an estimated useful life of five years. Our primary reasons for the acquisition were to expand our product portfolio in the traffic management market and to incorporate enhanced functionality into and complement our Roadway Sensors technologies.

Our unaudited condensed consolidated financial statements for the three and nine months ended December 31, 2009 include the results of operations of Hamilton Signal commencing as of the Closing. Disclosures required for material business combinations have been limited due to the immateriality of the acquisition of Hamilton Signal to our consolidated financial statements. No supplemental pro forma information is presented for the acquisition due to the immaterial effect of the acquisition on our results of operations.

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4. Revolving Line of Credit and Long-Term Debt

Revolving Line of Credit

In October 2008, we entered into a $19.5 million credit facility with California Bank & Trust, which provides for a two-year revolving line of credit with borrowings of up to $12.0 million and a $7.5 million 48-month term note (discussed below). Interest on borrowed amounts under the revolving line of credit are payable monthly at a rate equal to the current stated prime rate (3.25% at December 31, 2009) up to the current stated prime rate plus 0.50%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. We are obligated to pay an unused line fee of 0.25% per annum applied to the average unused portion of the revolving line of credit during the preceding month. The revolving line of credit does not contain any early termination fees and is secured by substantially all of our assets. As of December 31, 2009, no amounts were outstanding under the revolving line of credit portion of the facility.

Long-Term Debt

Our long-term debt consists of the following:

	December 31, 2009	March 31, 2009
	(In thousands)	
Bank term note	$ 5,750	$ 6,543
Convertible debentures, net		750
	5,750	7,293
Less current portion	(2,324)	(2,019)
	$ 3,426	$ 5,274

Convertible Debentures, Net. In May 2009, we retired the remaining $750,000 of convertible debentures that were outstanding as of March 31, 2009, which retirement was financed under our bank term note.

Bank Term Note. Under our current credit facility, which we entered into in October 2008, we may borrow up to $7.5 million in the form of a 48-month term note. Principal payments under this term note are required to be repaid in 48 monthly installments of $152,000 commencing on June 1, 2009. Additionally, beginning on November 1, 2009, and on November 1 of each year thereafter, we are required to repay additional principal of up to $500,000, calculated based on certain financial measures, as further defined in the agreement. These additional principal payments effectively reduce the total number of monthly installments necessary to repay the term note. As of December 31, 2009, an additional $500,000 was included in the current portion of the term note, representing the amount we estimate will be due on November 1, 2010. Interest on the term note is payable monthly at a rate equal to the current stated prime rate plus 0.50% up to the current stated prime rate plus 1.00% (3.75% to 4.25% at December 31, 2009), depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. The term note contains no early termination fees and, along with the revolving line of credit under the same credit agreement, is secured by substantially all of our assets.

5. Income Taxes

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
	(In thousands, except percentages)			
Benefit (provision) for income taxes	$ 48	$ (415)	$ (563)	$ (1,727)
Effective tax rate	(7.3)%	35.9%	28.7%	41.1%

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Our effective tax rates for the three and nine months ended December 31, 2009 were favorably impacted by the recognition of approximately $320,000 of unrecognized tax benefits during the three months ended December 31, 2009 due to the expiration of certain federal and state statutes in various jurisdictions. On an interim basis, we estimate what our anticipated annual effective tax rate will be, while also separately considering applicable discrete and other non-recurring items, and record a quarterly income tax provision in accordance with the anticipated annual rate. As the fiscal year progresses, we refine our estimates based on actual events and financial results during the year. This process can result in significant changes to our expected effective tax rate. When this occurs, we adjust our income tax provision during the quarter in which our estimates are refined so that the year-to-date provision reflects the expected annual effective tax rate. These changes, along with adjustments to our deferred taxes, among others, may create fluctuations in our overall effective tax rate from quarter to quarter.

6. Commitments and Contingencies

Litigation and Other Contingencies

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

Furthermore, from time to time, we have experienced unforeseen developments in contingencies related to our former subsidiaries. For example, we have been the subject of a number of routine tax audits for time periods and jurisdictions related to the businesses of our former subsidiaries. Although the development and ultimate outcome of these types of unforeseen matters cannot be anticipated or predicted with any certainty, our management does not believe that we are presently involved in any matters related to our former subsidiaries that would have a material adverse effect on our consolidated results of operations, financial position or cash flows.

Operating Lease

We previously subleased office space to MAXxess Systems, Inc. (MAXxess), one of our former subsidiaries that we sold in September 2003 and is currently owned by an investor group that includes two of our directors, one of whom is the 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 related ancillary 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 for $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. All amounts due from MAXxess continue to remain fully reserved.

Deferred Compensation Plan

In December 2009, we distributed to their respective owners the remaining assets in our Deferred Compensation Plan (the plan), which consisted of 23,844 shares of our common stock. This effectively terminated the plan, along with the corresponding trust in which the assets were held. As of December 31, 2009, the original $31,000 cost basis of these shares, which was previously recorded as a contra-equity account, along with the corresponding liability, were eliminated from our consolidated balance sheet.

7. Warrants

The following table summarizes information regarding outstanding warrants to purchase our common stock as of December 31, 2009:

Exercise Price		**Warrants Outstanding (In thousands)**	**Weighted Average Remaining Contractual Life (Years)**
$	1.42	15	3.7
	3.25	246	1.2
	5.00	75	0.6
		336	1.1

In May 2009, outstanding warrants with a weighted average per share exercise price of $3.93 to purchase approximately 674,000 shares of our common stock, which were associated with our convertible debentures (see Note 4), expired unexercised. In July 2009, outstanding warrants with a per share exercise price of $5.26 to purchase approximately 155,000 shares of our common stock expired unexercised.

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In connection with our adoption of certain provisions within ASC Topic 815, *Derivatives and Hedging*, which became effective for us on April 1, 2009, we determined that some of the outstanding warrants to purchase shares of our common stock contain 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. At December 31, 2009, the estimated fair value of the warrants was $16,000. The change in the estimated fair value of the warrants for the three and nine months ended December 31, 2009 is included in other income in the accompanying unaudited condensed consolidated statements of operations. We estimate the fair value of these warrants using the BSM option-pricing formula.

8. Fair Value Measurements

ASC 820 defines 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. ASC 820 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in an active market for identical assets or liabilities.

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

At December 31, 2009, there were outstanding warrants to purchase shares of our common stock that were classified as a liability with an estimated fair value of $16,000 (see Note 7). These warrants were valued using Level 3 inputs because there are unobservable inputs associated with them. The following table reconciles the liability for these warrants measured at fair value on a recurring basis using Level 3 inputs for the nine months ended December 31, 2009 (in thousands):

Balance at April 1, 2009	$	
Cumulative effect of accounting change (Note 7)		47
Gain on change in fair value included in net income		(31)
Balance at December 31, 2009	$	16

This liability is included within accrued liabilities in the accompanying unaudited condensed consolidated balance sheet as of December 31, 2009.

The intangible assets acquired in connection with the Hamilton Signal acquisition (see Note 3) were recorded at fair value as of the acquisition date of such assets, and were estimated using the income approach, which included the use of Level 3 inputs. 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.

9. Stockholders Equity

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.

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10. Stock-Based Compensation

A summary of activity in our stock option plans for the nine months ended December 31, 2009 is as follows:

	Number of Shares (In thousands)		Weighted Average Exercise Price
Options outstanding at March 31, 2009	3,314	$	1.92
Granted	393		1.43
Exercised	(76)		1.19
Forfeited	(30)		2.49
Expired	(309)		3.12
Options outstanding at December 31, 2009	3,292	$	1.76

In September 2009, our stockholders approved an amendment to increase the number of shares of our common stock authorized and reserved for issuance under our 2007 Omnibus Incentive Plan by 800,000 shares to a total of 1,650,000 shares. At December 31, 2009, there were 865,000 shares of common stock available for grant under this plan.

The per share fair values of stock options granted in the nine months ended December 31, 2009 have been estimated with the following weighted average assumptions:

Expected life - years		7
Risk-free interest rate		3.2%
Expected volatility of common stock		74%
Dividend yield		
Weighted-average grant date fair value per share	$	1.01

At December 31, 2009, there was approximately $982,000 of total unrecognized compensation expense related to unvested stock options. This expense is expected to be recognized over a weighted average period of approximately 3.2 years. If there are any modifications or cancellations of the underlying unvested stock options, 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 issue additional stock options or other stock-based awards.

11. Business Segment Information

We currently operate in three reportable segments: Roadway Sensors, Vehicle Sensors and Transportation Systems. The Roadway Sensors segment includes our Vantage and VersiCam vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications. This segment also includes our Pico compact video detection system, which was designed primarily to respond to international video detection needs. The Vehicle Sensors segment includes our lane departure warning products and is comprised of all of our activities related to vehicle safety. The Transportation Systems segment includes transportation engineering and consulting services and the development of transportation management and traveler information systems for the ITS industry. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Certain corporate expenses, including interest and amortization of intangible assets, are not allocated to the segments. The reportable segments are each managed separately because they manufacture and distribute distinct products or provide services with different processes. All segment revenues are derived from external customers.

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The following table sets forth selected unaudited financial information for our reportable segments for the three and nine months ended December 31, 2009 and 2008:

	Roadway Sensors	Vehicle Sensors	Transportation Systems	Total
		(In thousands)		
Three Months Ended December 31, 2009				
Product revenue	$ 5,734	$ 1,543	$	$ 7,277
Service and other revenue		124	6,176	6,300
Stock-based compensation	10	7	16	33
Depreciation and amortization	57	24	54	135
Segment income (loss)	582	(74)	283	791
Three Months Ended December 31, 2008				
Product revenue	$ 6,291	$ 2,477	$	$ 8,768
Service and other revenue		315	7,379	7,694
Stock-based compensation	8	12	13	33
Depreciation and amortization	48	32	65	145
Segment income	773	105	425	1,303
Nine Months Ended December 31, 2009				
Product revenue	$ 18,691	$ 3,542	$	$ 22,233
Service and other revenue		563	20,280	20,843
Stock-based compensation	28	23	46	97
Depreciation and amortization	176	64	168	408
Segment income (loss)	2,126	(910)	1,207	2,423
Nine Months Ended December 31, 2008				
Product revenue	$ 21,334	$ 8,380	$	$ 29,714
Service and other revenue		973	22,283	23,256
Stock-based compensation	24	36	39	99
Depreciation and amortization	144	105	185	434
Segment income	2,887	552	1,569	5,008

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
		(In thousands)		
Segment income:				
Total income from reportable segments	$ 791	$ 1,303	$ 2,423	$ 5,008
Unallocated amounts:				
Corporate and other expenses	(97)	(69)	(291)	(360)
Other income, net	25	63	42	90
Interest expense, net	(58)	(141)	(215)	(537)

Income before income taxes	$ 661	$ 1,156	$ 1,959	$ 4,201

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

This report, including the following discussion and analysis, contains forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995) that are based on our current expectations, estimates and projections about our business and our industry, and reflect management s beliefs and certain assumptions made by us based upon information available to us as of the date of this report. When used in this report and the information incorporated herein by reference, the words expect(s), feel(s), believe(s), should, will, may, anticipate(s), estimate(s) and similar expressions or variations of these words are intended to identify forward-looking statements. These forward-looking statements include, but are not limited to, statements regarding our anticipated sales, revenue, expenses, profits, capital needs, competition, development plans, backlog and manufacturing capabilities, the applications for and acceptance of our products and services, and the status of our facilities and product development. These statements are not guarantees of future performance and are subject to certain risks and uncertainties that could cause our actual results to differ materially from those projected. You should not place undue reliance on these forward-looking statements that speak only as of the date hereof. We encourage you to carefully review and consider the various disclosures made by us which describe certain factors which could affect our business, including in Risk Factors set forth in Part II, Item 1A of this report, before deciding to invest in our company or to maintain or increase your investment. We undertake no obligation to revise or update publicly any forward-looking statement for any reason, including to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

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Overview

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

We currently operate in three reportable segments: Roadway Sensors, Vehicle Sensors, and Transportation Systems. The Roadway Sensors segment includes our Vantage and VersiCam vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications. The Vehicle Sensors segment includes our lane departure warning (LDW) products and is comprised of all of our activities related to vehicle safety. The Transportation Systems segment includes transportation engineering and consulting services, and the development of transportation management and traveler information systems for the ITS industry.

Our Roadway Sensors segment product line uses advanced image processing technology to capture and analyze video images through sophisticated algorithms, enabling vehicle detection and transmission of both video images and data using various communication technologies. Our Vantage video detection systems detect vehicle presence, count, speed and other traffic data used in traffic management systems. This gives traffic managers the ability to mitigate roadway congestion by modifying traffic signal timing or detecting incidents quickly. VersiCam, our integrated camera and processor video detection system, is a cost-efficient video detection system for smaller intersections that requires only a few detection points. Vantage video detection systems have been deployed by hundreds of agencies and are currently sold through a network of independent dealers in the United States, Asia, Latin America, Europe and the Middle East. In December 2009, we introduced Pico, our compact video detection system that was developed primarily to address international video detection needs and was designed for easy installation and configuration. We anticipate 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 in-pavement loop technology, to manage traffic.

Our Vehicle Sensors segment addresses the leading cause of roadway fatalities: lane change, roadway departure and rear-end collision accidents. We developed the world s first production LDW system and offer a proven system that is available as an OEM and aftermarket option on heavy trucks worldwide and as an option in certain passenger cars. Our LDW products utilize video detection images to detect when a vehicle begins to drift toward an unintended lane change. When this occurs, the unit automatically emits a distinctive rumble strip or other audible warning sound, alerting the driver to make a correction. To date, we have sold approximately 75,000 LDW systems into the heavy truck market in Europe, North America and Asia. Our LDW systems are currently qualified as an option on certain heavy trucks, including Mercedes-Benz, MAN, Iveco, DAF, Scania, Freightliner and FUSO, as well as Neoplan and MAN luxury bus and coach lines. In North America, our LDW systems are sold primarily to truck fleets. We believe that as a result of the expected 2013 European mandate for LDW and other active safety systems, and an overall awareness of the potential benefits of LDW, that we will experience an even higher degree of competition from a variety of tier-one OEM suppliers and other potential market entrants, worldwide. While we believe that this increased competition validates the long-term market opportunity for LDW systems in commercial vehicles, it could also adversely effect our future LDW sales and margins. We are currently working with our major European OEM customer base to establish long-term supply agreements that extend to 2013 and beyond in order to meet the anticipated increase in demand; however, we cannot assure you that our efforts will be successful or that the increase in demand will occur. We have entered into an exclusive license of our LDW technology to our strategic partner, Valeo Schalter and Sensuren GmbH (Valeo), for the passenger car market, resulting in sales to date of approximately 73,500 LDW systems for passenger cars. Additionally, we and our partner have experienced a greater degree of competition in the passenger car market. Several passenger car OEMs have recently introduced vehicle platforms with competing LDW systems. Valeo continues to pursue opportunities in the passenger car market.

In addition to our LDW systems, our Vehicle Sensors portfolio includes technologies such as radar-based Forward Collision Warning (FCW) and Blind Spot Warning (BSW) systems for the North American truck market, which were both introduced in August 2008. Our Safety Direct product is a system that reports driver performance data captured by our LDW system, which data could be relayed directly to fleet operators through integration with the truck s existing fleet communications system. We offer the FCW and BSW features through the resale of Delphi s radar-based systems, for which we are the exclusive North American dealer, while Safety Direct was internally developed. These products, together with our LDW products, combine to create a suite of active safety driver assistance features focused on reducing the number of motor vehicle crashes and the severity of crash-related injuries.

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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, computer, and advanced communications equipment to enable public agencies to monitor, control and direct traffic flow, assist in the quick dispatch of emergency crews and distribute real-time information about traffic conditions. Our services include planning, design and implementation of surface transportation infrastructure systems. We perform analysis and study goods movement, commercial vehicle operations, travel demand forecasting and systems engineering, and identify mitigation measures to reduce traffic congestion. These services and systems are primarily sold to local, state and national transportation agencies in the United States; however, in the current fiscal year, we began work on our first overseas contract award in Abu Dhabi. In the future, we plan to continue to pursue additional international opportunities for our Transportation Systems segment.

Our Transportation Systems segment is largely dependent upon governmental funding and budgetary issues. We believe the overall expansion of our Transportation Systems segment in recent years was due in part to the passage of the Federal Highway Bill in 2005, combined with increased transportation funds available at state and local agencies throughout the country. The 2005 Federal Highway Bill expired on October 31, 2009, and Congress is currently in negotiations regarding future extensions. We anticipate possible delays in the enactment of a new Federal Highway Bill; however, we believe the current level of funding will continue until such time that the new bill is passed through Congress. This funding remains uncertain, and we cannot assure the timing or extent of such funding, nor the extent to which we may benefit.

Despite the federal stimulus package, many municipalities and other agencies continue to face budgetary issues. As a result, spending for new roadways, new systems to address traffic congestion and other transportation infrastructure improvements has been delayed or eliminated in some cases. We believe that the need to rebuild and modernize aging transportation infrastructure will continue, and in addition to funds available through the stimulus package and federal highway bills, there exist a variety of other funding mechanisms that support transportation infrastructure and related projects, including bonds, dedicated sales and gas tax measures and other alternative funding sources. However, we currently cannot determine when or if such funding sources will be available or the extent to which we may benefit from future sources of funding for transportation-related projects.

Critical Accounting Policies and Estimates

Management s Discussion and Analysis of Financial Condition and Results of Operations is based on our unaudited condensed consolidated financial statements included herein, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate these estimates and assumptions, including those related to the collectibility of accounts receivable, the valuation of inventories, the recoverability of long-lived assets and goodwill, the realizability of deferred tax assets, accounting for stock-based compensation, the valuation of equity instruments, warranty reserves and other contingencies. We base these estimates on our historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. These estimates and assumptions by their nature involve risks and uncertainties, and may prove to be inaccurate. In the event that any of our estimates or assumptions are inaccurate in any material respect, it could have a material adverse effect on our reported assets and liabilities at the date of the financial statements and our reported revenues and expenses during the reporting period.

The accounting policies that affect our more significant judgments and estimates used in the preparation of our unaudited condensed consolidated financial statements are those relating to revenue recognition, accounts receivable, inventory, goodwill, warranty, income taxes, and stock-based compensation. These policies are described in further detail in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009 (fiscal 2009). There have been no significant changes in our critical accounting policies and estimates during the nine months ended December 31, 2009 as compared to what was previously disclosed in our Annual Report on Form 10-K for fiscal 2009.

Recent Accounting Pronouncements

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

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Results of Operations

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Net sales and contract revenues:				
Net sales	54.5%	55.2%	52.9%	57.9%
Contract revenues	45.5	44.8	47.1	42.1
Total net sales and contract revenues	100.0%	100.0%	100.0%	100.0%
Costs of net sales and contract revenues:				
Cost of net sales	28.3	29.7	28.1	30.3
Cost of contract revenues	30.9	30.8	30.9	27.9
Gross profit	40.8	39.5	41.1	41.8
Operating expenses:				
Selling, general and administrative	28.8	26.6	29.5	26.8
Research and development	6.6	5.2	6.4	6.0
Amortization of intangible assets	0.3	0.2	0.3	0.2
Total operating expenses	35.7	32.0	36.1	33.0
Operating income	5.1	7.5	4.9	8.8
Non-operating income (expense):				
Other income, net	0.2	0.4	0.1	0.2
Interest expense, net	(0.4)	(0.9)	(0.5)	(1.0)
Income before income taxes	4.9	7.0	4.5	7.9
Benefit (provision) for income taxes	0.4	(2.5)	(1.3)	(3.3)
Net income	5.2%	4.5%	3.2%	4.7%

Analysis of Quarterly Results of Operations

Net Sales and Contract Revenues. Net sales are comprised of product sales from our Roadway Sensors and Vehicle Sensors segments, as well as contract engineering revenue and royalty revenue generated from our Vehicle Sensors segment. Contract revenues consist entirely of Transportation Systems contract revenues, which are generated from systems integration and ITS consulting services primarily with federal, state, county and municipal agencies.

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The following tables present details of our net sales and contract revenues for the three and nine months ended December 31, 2009 and 2008:

	Three Months Ended December 31, 2009	Three Months Ended December 31, 2008	Decrease	% Change
	(In thousands, except percentages)			
Roadway Sensors	$ 5,734	$ 6,291	$ (557)	(8.9)%
Vehicle Sensors	1,667	2,792	(1,125)	(40.3)
Net sales	7,401	9,083	(1,682)	(18.5)
Contract revenues	6,176	7,379	(1,203)	(16.3)
Total net sales and contract revenues	$ 13,577	$ 16,462	$ (2,885)	(17.5)

	Nine Months Ended December 31, 2009	Nine Months Ended December 31, 2008	Decrease	% Change
	(In thousands, except percentages)			
Roadway Sensors	$ 18,691	$ 21,334	$ (2,643)	(12.4)%
Vehicle Sensors	4,105	9,353	(5,248)	(56.1)
Net sales	22,796	30,687	(7,891)	(25.7)
Contract revenues	20,280	22,283	(2,003)	(9.0)
Total net sales and contract revenues	$ 43,076	$ 52,970	$ (9,894)	(18.7)

We have historically had a diverse customer base. For the nine month periods ended December 31, 2009 and 2008, no individual customer accounted for greater than 10% of our total net sales and contract revenues.

Roadway Sensors

The decrease in Roadway Sensors net sales for the three and nine months ended December 31, 2009 as compared to the corresponding periods in the prior fiscal year was mainly due to the ongoing effects of reduced and delayed spending on infrastructure projects, in part due to the decline in commercial and residential construction as well as state and local government budgetary pressures and increased competitors in the market. We believe these factors are at least partially attributable to the overall continued weakness in the U.S. and global economy. We expect the above factors, among others, may continue to adversely impact our Roadway Sensors net sales for at least the next few fiscal quarters. Additionally, winter weather conditions have historically had a negative impact on Roadway Sensors net sales in our fiscal third and fourth quarters in the regions where projects can be delayed due to such factors. In December 2009, we began selling our products directly to contractors in Texas. We plan to continue selling product to our former distributor under the state procurement contract.

Vehicle Sensors

The largest element of Vehicle Sensors net sales was sales of our LDW systems to the heavy truck market, which aggregated approximately $1.5 million and $3.5 million for the three and nine months ended December 31, 2009, respectively, compared to approximately $2.5 million and

$8.4 million for the three and nine months ended December 31, 2008, respectively. Vehicle Sensors net sales decreased for the current fiscal year primarily due to the slowdown in overall LDW unit shipments to each of our key markets during the current year. Although we saw an encouraging increase in net sales in the current fiscal quarter as compared to the immediately preceding quarter, which resulted primarily from increased sales to certain of our U.S. truck fleet customers, we continue to experience overall softness in our LDW unit sales to the North American truck market and to our European and Asian OEM customers, which we believe is driven largely by lower new heavy truck sales in general, as well as the general slowdown in the U.S. and worldwide credit markets and continued weakness in the overall global economy. We anticipate that Vehicle Sensors unit sales for the remainder of the fiscal year ending March 31, 2010 (fiscal 2010) and beyond could continue to be adversely impacted as a result of the overall decline in sales of heavy trucks globally and by slower than expected adoption rates of our LDW system by European and Asian OEMs and North American heavy truck fleets. Additionally, future unit sales of LDW systems and unit pricing could be adversely impacted as a result of increased competition in this market. The increase in competition in the current fiscal year contributed to a division of an international heavy truck customer sourcing future primary LDW unit sales to a competitor for a specific geographic region.

Also included in Vehicle Sensors net sales are revenues from contract engineering services and royalty revenues in the passenger car market that are derived from our strategic relationship with Valeo, which aggregated approximately $124,000 and $563,000 for the three and nine months ended December 31, 2009, respectively, compared to $315,000 and $973,000 for the three and nine months ended December 31, 2008, respectively. The decline in the current fiscal year primarily reflects an overall decrease in contract engineering services provided to Valeo as the pertinent engineering development activities have generally reached maturity for the related vehicle platforms that currently incorporate our LDW system.

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Contract Revenues

Contract revenues are primarily dependent upon the continued availability of funding at both the state and federal levels from the various departments of transportation. For the three and nine months ended December 31, 2009, our contract revenues decreased compared to the corresponding period in the prior fiscal year due to the timing of sub-consulting content revenues, as well as delays or reductions in funding for certain of our projects, particularly in the Southeast region of the U.S. In the future, we plan to continue to pursue large contracts that may contain significant sub-consulting content, which will likely contribute to variability in the timing and amount of our contract revenues from period to period. We believe the ability of our Transportation Systems business to grow and successfully win and service new contracts will remain highly dependent upon our continued success in recruiting and retaining qualified personnel. Historically, all of our contract revenues have been derived from work performed in North America under a broad range of fixed price and cost plus fixed fee contracts. Beginning in the second quarter of fiscal 2010, we began work on our first overseas contract award to assist the Abu Dhabi Department of Transport in the development of certain ITS architecture. To date, revenues from this contract have not been significant.

Gross Profit. The following tables present details of our gross profit for the three and nine months ended December 31, 2009 and 2008:

	Three Months Ended December 31, 2009	**2008**	**Decrease**	**% Change**
	(In thousands, except percentages)			
Total gross profit	$ 5,535	$ 6,504	$ (969)	(14.9)%
Total gross profit as a % of total net sales and contract revenues	40.8%	39.5%		
Gross profit as a % of net sales	48.1%	46.2%		
Gross profit as a % of contract revenues	32.0%	31.3%		

	Nine Months Ended December 31, 2009	**2008**	**Decrease**	**% Change**
	(In thousands, except percentages)			
Total gross profit	$ 17,687	$ 22,131	$ (4,444)	(20.1)%
Total gross profit as a % of total net sales and contract revenues	41.1%	41.8%		
Gross profit as a % of net sales	46.9%	47.7%		
Gross profit as a % of contract revenues	34.5%	33.6%		

Our gross margin for the three months ended December 31, 2009 increased slightly compared to the corresponding period in the prior fiscal year primarily as a result of higher overall margins from our net sales during this period and, to a lesser extent, due to a slight improvement in our Transportation Systems margins, as discussed further below. On a fiscal year-to-date basis, the slight decline in our gross margin in the current fiscal year, as compared to the same period in the prior fiscal year, was primarily the result of a higher mix of contract revenues, which represented approximately 47% of our total net sales and contract revenues thus far in the current fiscal year as compared to approximately 42% in the same period in the prior fiscal year. Generally, contract revenues carry lower margins than our net sales.

The increase in gross profit as a percent of net sales for the three months ended December 31, 2009 as compared to the corresponding period in the prior year was primarily a result of higher margins in Roadway Sensors during the current quarter, driven largely by our customer mix. The overall slight decrease in gross profit as a percent of net sales for the nine months ended December 31, 2009 as compared to the corresponding period in the prior year was primarily a result of decreased overall gross profit during the current fiscal year in Vehicle Sensors, which was largely driven by lower overhead absorption due to the decline in sales in the current fiscal year, as well as an increase in certain estimates for additional excess and obsolete inventory provisions. Gross profit as a percentage of net sales 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 possible shifts of engineering resources from development activities to sustaining activities, which we record as cost of goods sold.

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We recognize contract revenues and related gross profit using percentage of completion contract accounting, and the underlying mix of contract activity affects the related gross profit recognized in any given period. The slight increase in gross profit as a percent of contract revenues for both the three and nine months ended December 31, 2009 compared to the corresponding periods in the prior year was primarily due to a contract mix weighted more toward higher margin contracts in the current fiscal year. Our higher margin contracts often contain a comparatively lower proportion of sub-consulting revenues. For the remainder of fiscal 2010, we expect an overall lower level of sub-consulting content as a percentage of our total contract revenues, as compared to the prior year; however, due to the variability and timing of our contracts, it has become increasingly difficult to accurately predict the sub-consulting content in our Transportation Systems contracts in future periods.

Selling, General and Administrative Expense. The following tables present selling, general and administrative expense for the three and nine months ended December 31, 2009 and 2008:

	Three Months Ended December 31, 2009		Three Months Ended December 31, 2008			
	Amount	% of Net Sales and Contract Revenues	Amount	% of Net Sales and Contract Revenues	Increase (Decrease)	% Change
		(In thousands, except percentages)				
Salary and personnel-related	$ 2,611	19.2%	$ 2,828	17.2%	$ (217)	(7.7)%
Facilities, insurance and supplies	436	3.2	616	3.7	(180)	(29.2)
Travel and conferences	346	2.5	397	2.4	(51)	(12.8)
Professional and outside services	205	1.5	295	1.8	(90)	(30.5)
Other	317	2.3	249	1.5	68	27.3
Selling, general and administrative	$ 3,915	28.8%	$ 4,385	26.6%	$ (470)	(10.7)

	Nine Months Ended December 31, 2009		Nine Months Ended December 31, 2008			
	Amount	% of Net Sales and Contract Revenues	Amount	% of Net Sales and Contract Revenues	Decrease	% Change
		(In thousands, except percentages)				
Salary and personnel-related	$ 8,518	19.8%	$ 9,245	17.5%	$ (727)	(7.9)%
Facilities, insurance and supplies	1,708	4.0	1,846	3.5	(138)	(7.5)
Travel and conferences	1,042	2.4	1,210	2.3	(168)	(13.9)
Professional and outside services	794	1.8	1,130	2.1	(336)	(29.7)
Other	633	1.5	762	1.4	(129)	(16.9)
Selling, general and administrative	$ 12,695	29.5%	$ 14,193	26.8%	$ (1,498)	(10.6)

The decreases in selling, general and administrative expense for the three and nine months ended December 31, 2009 compared to the corresponding periods in the prior year were primarily due to (i) our overall reduction in headcount from December 31, 2008 levels; (ii) lower accruals for bonuses and other incentive compensation primarily due to lower sales in the current periods; and (iii) the suspension of our matching contributions under our 401(k) plan effective July 1, 2009. During the current fiscal year, we also reduced our professional and outside services expenses primarily as a result of our efforts to conserve costs and scale back our usage of these services, along with various efficiencies gained in our internal control assessment and other financial reporting obligations.

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Research and Development Expense. The following tables present research and development expense for the three and nine months ended December 31, 2009 and 2008:

	Three Months Ended December 31, 2009		Three Months Ended December 31, 2008			
	Amount	% of Net Sales and Contract Revenues	Amount	% of Net Sales and Contract Revenues	Increase (Decrease)	% Change
		(In thousands, except percentages)				
Salary and personnel-related	$ 613	4.5%	$ 577	3.5%	$ 36	6.2%
Facilities, development and supplies	245	1.8	217	1.3	28	12.9
Other	32	0.2	54	0.3	(22)	(40.7)
Research and development	$ 890	6.6%	$ 848	5.2%	$ 42	5.0

	Nine Months Ended December 31, 2009		Nine Months Ended December 31, 2008			
	Amount	% of Net Sales and Contract Revenues	Amount	% of Net Sales and Contract Revenues	Decrease	% Change
		(In thousands, except percentages)				
Salary and personnel-related	$ 1,957	4.5%	$ 2,207	4.2%	$ (250)	(11.3)%
Facilities, development and supplies	676	1.6	782	1.5	(106)	(13.6)
Other	105	0.2	191	0.4	(86)	(45.0)
Research and development	$ 2,738	6.4%	$ 3,180	6.0%	$ (442)	(13.9)

During the three months ended December 31, 2009, we saw a slight increase in personnel-related research and development expenses as compared to the same period in the prior fiscal year as we have dedicated additional resources to certain research and development activities within Vehicle Sensors. The overall decrease in research and development expense for the nine months ended December 31, 2009 compared to the corresponding period in the prior year is primarily due to lower overall engineering headcount and a shift in engineering resources to an organization more focused on new product development from one that has been historically focused on new customer qualification and manufacturing support. We believe this structure to be more efficient. We believe that research and development activities are crucial to our ability to continue to be a leader in our markets. We currently expect our total research and development expenditures for fiscal 2010 will be slightly lower to flat when compared to fiscal 2009.

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

Interest Expense, Net. Net interest expense of $58,000 and $215,000 for the three and nine months ended December 31, 2009, respectively, was lower than the $141,000 and $537,000 for the three and nine months ended December 31, 2008, respectively, primarily due to the overall lower level of borrowings in the current fiscal year, as well as lower interest rates on our term note.

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Income Taxes. The following tables present our benefit (provision) for income taxes for the three and nine months ended December 31, 2009 and 2008:

	Three Months Ended December 31, 2009	2008	Decrease	% Change
	(In thousands, except percentages)			
Benefit (provision) for income taxes	$ 48	$ (415)	$ 463	(112)%
Effective tax rate	(7.3)%	35.9%		

	Nine Months Ended December 31, 2009	2008	Decrease	% Change
	(In thousands, except percentages)			
Benefit (provision) for income taxes	$ (563)	$ (1,727)	$ 1,164	(67)%
Effective tax rate	28.7%	41.1%		

Our effective tax rates for the three and nine months ended December 31, 2009 were favorably impacted by the recognition of approximately $320,000 of unrecognized tax benefits during the three months ended December 31, 2009 due to the expiration of certain federal and state statutes in various jurisdictions. On an interim basis, we estimate what our anticipated annual effective tax rate will be, while also separately considering applicable discrete and other non-recurring items, and record a quarterly income tax provision in accordance with the anticipated annual rate. As the fiscal year progresses, we refine our estimates based on actual events and financial results during the year. This process can result in significant changes to our expected effective tax rate. When this occurs, we adjust our income tax provision during the quarter in which our estimates are refined so that the year-to-date provision reflects the expected annual effective tax rate. These changes, along with adjustments to our deferred taxes, among others, may create fluctuations in our overall effective tax rate from quarter to quarter.

Liquidity and Capital Resources

Cash Flows

We have historically financed our operations with a combination of cash flows from operations, borrowings under credit facilities and the sale of equity securities. We currently rely on cash flows from operations and the availability of borrowings on a line of credit facility to fund our operations, which we believe are sufficient to fund our operations for at least the next twelve months. At December 31, 2009, we had $20.3 million in working capital, which included no borrowings on our $12.0 million line of credit and $9.4 million in cash and cash equivalents. Our working capital at March 31, 2009 was $20.6 million and included no borrowings on our line of credit and $6.4 million in cash and cash equivalents.

The following table summarizes our cash flows for the nine months ended December 31, 2009 and 2008:

Nine Months Ended

	December 31, 2009		December 31, 2008	
	(In thousands)			
Net cash provided by (used in):				
Operating activities	$	4,912	$	6,030
Investing activities		(480)		(716)
Financing activities		(1,453)		240

Operating Activities. Cash provided by our operations for the nine months ended December 31, 2009 was primarily the result of (i) our net income of $1.4 million during the current period; (ii) $1.7 million in non-cash items within the statement of operations, primarily adjustments to our deferred tax assets and depreciation expense; and (iii) $1.8 million in cash resulting from changes in our operating assets and liabilities during the period. Additionally, our total cash and cash equivalents balance of $9.4 million at December 31, 2009 was negatively affected by approximately $1.0 million in disbursements for payroll and facilities rents that we made near the end of December 2009 due to holiday timing conflicts. These payments were originally scheduled to be made, and would have otherwise been disbursed, in January 2010. Cash provided by operating activities during the nine months ended December 31, 2008 was primarily the result of our net income during that period of $2.5 million and $3.1 million in non-cash items within the statement of operations, primarily adjustments to our deferred tax assets and depreciation expense.

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Our net accounts receivable decreased approximately $2.4 million from March 31, 2009 to December 31, 2009 due in part to our lower overall net sales and contract revenues in fiscal 2010 as compared to fiscal 2009 levels. During the current fiscal year, we have also been successful in collecting our outstanding receivables within our expected payment terms. In the future, our accounts receivable could increase if, among other factors, customers delay their payments or if we grant extended payment terms to customers, both of which are more likely to occur during challenging economic times when our customers may face issues gaining sufficient credit on a timely basis or on acceptable terms.

Inventories decreased approximately $2.5 million from March 31, 2009 to December 31, 2009 as we worked through higher inventory levels on-hand as of March 31, 2009, which were partially due to the introduction of new Roadway Sensors products and the acquisition of various components that were discontinued by the manufacturer. During the current fiscal year, we have also focused on reducing our inventory purchases to reflect the overall reduction in our net sales and the ongoing economic slowdown. 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 or potentially excess inventory levels.

Investing Activities. Our investing activities for the nine months ended December 31, 2009 consisted of purchases of property and equipment of $180,000, as well as $300,000 used for the acquisition of Hamilton Signal. Cash used in investing activities for the nine months ended December 31, 2008 consisted entirely of purchases of property and equipment of $716,000.

Financing Activities. Net cash used in financing activities during the nine months ended December 31, 2009 was the result of net payments on our long-term debt of $1.5 million, which included an additional lump-sum principal payment of $500,000 made in November 2009. The net payments on our long-term debt were partially offset during the period by $90,000 in proceeds received from the exercise of outstanding stock options to purchase shares of our common stock. During the nine months ended December 31, 2008, cash provided by financing activities was primarily the result of $911,000 in proceeds from the exercise of outstanding stock options to purchase shares of our common stock, partially offset by net payments on our long-term debt of $671,000.

Borrowings

In October 2008, we entered into a $19.5 million credit facility with California Bank & Trust, which provides for a two-year revolving line of credit with borrowings of up to $12.0 million and a $7.5 million 48-month term note (discussed below). Interest on borrowed amounts under the revolving line of credit are payable monthly at a rate equal to the current stated prime rate (3.25% at December 31, 2009) up to the current stated prime rate plus 0.50%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. We are obligated to pay an unused line fee of 0.25% per annum applied to the average unused portion of the revolving line of credit during the preceding month. The revolving line of credit does not contain any early termination fees and is secured by substantially all of our assets. As of December 31, 2009, no amounts were outstanding under the revolving line of credit portion of the facility.

As of December 31, 2009, we had outstanding borrowings of approximately $5.8 million under the term note. Principal payments under this term note are required to be repaid in 48 monthly installments of $152,000 commencing on June 1, 2009. Additionally, beginning on November 1, 2009, and on November 1 of each year thereafter, we are required to repay additional principal of up to $500,000, calculated based on certain financial measures, as further defined in the agreement. These additional principal payments effectively reduce the total number of monthly installments necessary to repay the term note. Interest on the term note is payable monthly at a rate equal to the current stated prime rate plus 0.50% up to the current stated prime rate plus 1.00% (3.75% to 4.25% at December 31, 2009), depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. The term note contains no early termination fees and, along with our revolving line of credit discussed above, is secured by substantially all of our assets.

In connection with our credit facility and loan agreement with California Bank & Trust, 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 and expect to maintain compliance for the foreseeable future, we cannot assure 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, 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.

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Off Balance Sheet Arrangements

At December 31, 2009, we had outstanding warrants to purchase an aggregate of 246,250 shares of our common stock at an exercise price of $3.25 per share that are callable by us if the market price of our common stock trades for 20 consecutive days at a price equal to or greater than $6.50 per share. We also had outstanding warrants to purchase an aggregate of 75,000 shares of our common stock at an exercise price of $5.00 per share that are callable by us if the market price of our common stock trades for 20 consecutive days at a price equal to or greater than $7.50 per share.

In connection with the issuance of warrants to purchase 246,250 shares of our common stock at $3.25 per share (discussed above), we are a party to a registration rights agreement that contains provisions under which we could be subjected to liquidated damages should we fail to maintain effective registration statements for the shares of common stock issuable upon exercise of certain underlying warrants. Through March 31, 2009, these warrants were accounted for within equity in our consolidated balance sheets and, accordingly, no liabilities were recorded in connection therewith. Beginning April 1, 2009, as further discussed at Note 7 of Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report, because these warrants contain a provision for possible future adjustments to either the exercise price and/or number of shares to be issued upon exercise, we began recognizing these warrants as liabilities in our consolidated balance sheet. As of the date of this filing, no liquidated damages are payable under the provisions of the registration rights agreement associated with these warrants.

Seasonality

We have historically experienced, and expect to continue to experience seasonality, particularly with respect to our Roadway Sensors net sales in the third and fourth fiscal quarters due to a reduction in road construction or repairs during the winter months in many markets as a result of inclement weather conditions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to interest rate risk is limited to our line of credit and our bank term note. Our line of credit bears interest equal to the prevailing prime rate (3.25% at December 31, 2009) plus 0% to 1.0%. We do not believe that a 10% increase in the interest rate on our line of credit or term note would have a material impact on our financial position, operating results or cash flows. In addition, we believe that the carrying value of our outstanding debt under our credit facility approximates fair value.

ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Controls

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

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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.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth under the heading Litigation and Other Contingencies in Note 6 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item I of this report, is incorporated herein by reference.

ITEM 1A. RISK FACTORS

Our business is subject to a number of risks, some of which are discussed below. Other risks are presented elsewhere in this report and in the information incorporated by reference into this report. You should consider the following risks carefully in addition to the other information contained in this report and our other filings with the SEC, including our annual report on Form 10-K and subsequent reports on Forms 10-Q and 8-K, before deciding to buy, sell, or hold our common stock. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. If any of these risks actually occurs, our business, financial condition, or results of operations could be seriously harmed. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

The economic slowdown has adversely impacted real estate development, reduced and delayed government funding for transportation infrastructure projects and initiatives and decreased availability of financial capital for our customers, all of which is adversely impacting our net sales and could impact our contract 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 increasingly present at all levels of government. These unfavorable economic conditions are having a negative impact on customer orders and government funding of infrastructure projects incorporating our products and services. Such factors have and may continue to result in cancellations and rescheduling of backlog and customer orders. In addition, the recent decline in the U.S. real estate market, particularly in new home and commercial construction, has adversely impacted new road construction and is resulting in and may continue to result in flat or declining Roadway Sensor and Vehicle Sensor net sales in future periods and have also adversely impacted Transportation Systems contract revenues. Any of the foregoing economic conditions make it extremely difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. Additionally, there continues to be uncertainties regarding the impact of the federal stimulus package and the fact that the accessibility of funds appears to be taking longer than originally anticipated. If such conditions continue or worsen, our business, financial condition and results of operations could be materially and adversely affected.

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 sales are derived from contracts with governmental agencies, either as a general contractor, subcontractor or supplier. Government contracts represented approximately 45%, 38% and 38% of our total net sales and contract revenues for the fiscal years ended March 31, 2009, 2008 and 2007, respectively. We anticipate that revenue from government contracts will continue to remain a significant portion of our net sales and contract revenues. Government business is, in general, subject to special risks and challenges, including:

- delays in funding, including delays in the allocation of funds to state and local agencies from the U.S. federal government as a result of the expiration of the 2005 Federal Highway Bill on October 31, 2009, as well as delays or reductions in stimulus funds dedicated for transportation projects;

- long purchase cycles or approval processes;

- competitive bidding and qualification requirements;

- the impact of international conflicts;

- performance bond requirements;

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- changes in government policies and political agendas;
- other government budgetary constraints, cut-backs, delays or reallocation of government funding;
- milestone requirements and liquidated damage provisions for failure to meet contract milestones; 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 net sales and contract revenues and income to drop substantially or to fluctuate significantly between fiscal periods.

In addition, a large number of our government contracts are fixed price contracts. As a result, we may not be able to recover any cost overruns we may incur. These fixed price contracts require us to estimate the total project cost based on preliminary projections of the project s requirements. The financial viability of any given project depends in large part on our ability to estimate these costs accurately and complete the project on a timely basis. In the event our costs on these projects exceed the fixed contractual amount, we will be required to bear the excess costs. Such additional costs would adversely affect our financial condition and results of operations. Moreover, certain of our government contracts are subject to termination or renegotiation at the convenience of the government, which could result in a large decline in our net sales and contract revenues in any given quarter. Our inability to address any of the foregoing concerns or the loss or renegotiation of any material government contract could seriously harm our business, financial condition and results of operations.

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 federal stimulus monies to the state, changes in state funding allocations to local agencies and municipalities, or other delays in purchasing for, or commencement of, transportation projects has and may continue to have a negative impact on our net sales and contract revenues and our income.

The markets in which we operate are highly competitive and have many more established competitors, which could adversely affect our sales or the market acceptance of our products. We compete with numerous other companies in our target markets including, but not limited to, large, multinational corporations, which include tier-one automotive suppliers, and many smaller regional engineering firms. We believe that as a result of the expected 2013 European mandate for LDW and other active safety systems, and an overall awareness of the potential benefits of LDW, that we will experience an even higher degree of competition from a variety of tier-one OEM suppliers and other potential market entrants, worldwide. We also expect such competition to increase due to technological advancements, industry consolidations and reduced barriers to entry. Increased competition is likely to 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. For example, a developer of LDW systems was acquired by a large multinational organization during fiscal 2009. This new competitor has increased its market share and could be more aggressive in both the passenger car and heavy truck markets as a result of its greater access to resources and reputation in the market. Furthermore, awareness of LDW technology is increasing and other market players have developed competing technologies, which may contain improvements or added features beyond those offered by our LDW systems. Additionally, from time to time, we may be required to re-compete for LDW business from our main customer base of heavy truck OEMs. These OEMs could make a supplier change based on price, product performance or available features. Should our competition be successful, this could adversely affect our ability to successfully market and sell our LDW systems to new and existing customers.

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.

Many of our competitors have far greater name recognition and greater financial, technological, marketing, and customer service resources than we do. This may allow them to respond more quickly to new or emerging technologies and changes in customer requirements. It may also allow them to devote greater resources to the development, promotion, sale and support of their products than we can. Recent consolidations of end users, distributors and manufacturers in our target markets have exacerbated this problem.

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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 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 in the past acquired, and may in the future acquire, complementary businesses, products, and technologies. Acquisitions may require significant capital infusions and, in general, acquisitions also involve a number of special risks, including:

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

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

We 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.

We may be unable to attract and retain key personnel, which could seriously harm our business. Due to the specialized nature of our business, we are highly dependent on the continued service of our executive officers and other key management, engineering and technical personnel. The loss of Abbas Mohaddes, our Chief Executive Officer, or any of the other executive officers or key members of management could adversely affect our business, financial condition, or results of operations. Our success will also depend in large part upon our ability to continue to attract, retain and motivate qualified engineering and other highly skilled technical personnel. In particular, the future success of our Transportation Systems segment will depend on our ability to hire additional qualified engineers and planners. Competition for qualified employees, particularly development engineers, is intense. We may not be able to continue to attract and retain sufficient numbers of such highly skilled employees. Our inability to attract and retain additional key employees or the loss of one or more of our current key employees could adversely affect our business, financial condition and results of operations.

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 or any enhancements to our existing products on a timely basis, or at all. In addition, the introduction of any new products could adversely affect the sales of certain of our existing products.

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

Market acceptance of our new products depends upon many factors, including our ability to accurately predict market requirements and evolving industry standards, our ability to resolve technical challenges in a timely and cost-effective manner, qualify any new products with OEMs and achieve manufacturing efficiencies, the perceived advantages of our new products over traditional products and the marketing capabilities of our independent distributors and strategic partners, including Valeo s ability to expand sales of LDW systems in the passenger car market. The success of our LDW system will also depend in part on the success of the automotive vehicles that incorporate our technology, as well as the success of optional equipment that OEMs bundle with our technologies.

Certain of the components used in our products may need to be re-engineered in the next 12 to 36 months as the industry is moving towards a standard of using lead-free components. We cannot assure you as to our ability to successfully redesign our products to incorporate compliant components and gain market acceptance of such redesigned products. In addition, we may experience a shortage of products as a result of potential scarcity of lead-free components.

Our business and results of operations could also be seriously harmed by any significant delays in our new product development. Certain of our new products could contain undetected design faults and software errors or bugs when first released by us, despite our testing. We may not discover these faults or errors until after a product has been installed and used by our customers. Any faults or errors in our existing products or in any new products may cause delays in product introduction and shipments, require design modifications or harm customer relationships, any of which could adversely affect our business and competitive position.

New environmental regulations may result in a decline in our Vehicle Sensors net sales. From time to time, environmental regulations are enacted, which can significantly increase the cost of manufacturing new vehicles as well as the cost of maintaining existing vehicles and truck fleets. As a result, we could experience a decline in sales of our Vehicle Sensors products as truck and vehicle manufacturers and fleet operators attempt to control their costs.

We depend upon Valeo to market our LDW technologies for the OEM passenger car market. We have granted Valeo the exclusive right to sell and manufacture our LDW system to the worldwide passenger car market in exchange for royalty payments for each LDW unit sold. As such, the future success and broad market acceptance of our technologies in the passenger car market will depend upon Valeo s ability to manufacture, market and sell our technologies, and to convince more OEM passenger car manufacturers to adopt our technologies. To date, we have not generated significant royalties from Valeo s efforts and have only been designed into one car OEM product line. If Valeo does not devote considerable resources and aggressively pursue opportunities, our expansion into the passenger car market, and our related revenues from contract engineering services and royalty revenues could be adversely affected or not materialize as originally anticipated.

If we do not keep pace with rapid technological changes and evolving industry standards, we will not be able to remain competitive and there will be no demand for our products. Our markets are in general characterized by the following factors:

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

Our future success will depend upon our ability to anticipate and adapt to changes in technology and industry standards, and to effectively develop, introduce, market and gain broad acceptance of new products and product enhancements incorporating the latest technological advancements. In particular, our LDW systems are incorporated into automobiles and trucks that face significant technological changes in each model year and among different vehicle models. Accordingly, we must adapt our technology from time to time to function with such changes.

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Our international business operations may be threatened by many factors that are outside of our control. We currently market our products internationally and we anticipate that our international operations may expand in the near future. International business operations are subject to various inherent risks including, among others:

- currency fluctuations and restrictions;
- political, social and economic instability;
- longer accounts receivable payment cycles;
- import and export license requirements and restrictions of the United States and each other country in which we operate;
- unexpected changes in regulatory requirements, tariffs and other trade barriers or restrictions;
- the burdens of compliance with a wide variety of foreign laws and more restrictive labor laws and obligations;
- difficulties in managing and staffing international operations;
- potentially adverse tax consequences; and
- reduced protection for intellectual property rights in some countries.

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

Any of the factors mentioned above may adversely affect our future international sales and, consequently, affect our business, financial condition and operating results. Furthermore, as we increase our international sales, our total revenues may also be affected to a greater extent by seasonal fluctuations resulting from lower sales that typically occur during the summer months in Europe and other parts of the world.

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. Currently, we expect that beginning in our fiscal year ending March 31, 2011, our independent registered public accounting firm will also be required to attest to, and report on, the effectiveness of our internal controls over financial reporting. 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.

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We may need to raise additional capital in the future, which may not be available on terms acceptable to us, or at all. Until recently, we have historically generated significant net losses and operating losses, and have experienced volatility in our cash flows from operations from year to year. Although we entered into a $19.5 million credit facility, effective October 2008, should we have an event of default, which includes, among other things, a failure to meet certain financial covenants and a material adverse change in the business, the bank could choose to limit or take away our ability to borrow these or any funds. Should this occur, or if the credit markets further tighten, we may need or choose to raise additional capital to pursue acquisitions or to expand our operations.

At December 31, 2009, we had $9.4 million of cash and cash equivalents and the availability of borrowing against our $12.0 million line of credit to fund our operations. We may need to raise additional capital in the near future to fund our operations or to repay indebtedness. Such additional capital may be raised through bank borrowings, or other debt or equity financings. We cannot assure you that any additional capital will be available on a timely basis, on acceptable terms, or at all, and such additional financing may result in further dilution to our stockholders.

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

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

• our relationships with customers and suppliers;

• government budgets, political agendas and other funding issues, including potential delays in government contract awards;

• our ability to successfully negotiate credit arrangements with our bank; and

• general economic conditions, including the effects of the current economic slowdown and international conflicts.

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

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

• delays in government contracts and funding from time to time and budgetary constraints at the federal, state and local levels, including stimulus and other funding;

• declines in new home and commercial real estate construction and related road and other infrastructure construction;

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- changes in our pricing policies and the pricing policies of our suppliers and competitors, pricing concessions on volume sales, as well as increased price competition in general;
- the long lead times associated with government contracts or required by vehicle manufacturers;
- the size, timing, rescheduling or cancellation of significant customer orders;
- our ability to control costs;
- our ability to raise additional capital;
- the mix of our products and services sold in a quarter, which mix has varied and is expected to continue to vary from time to time;
- seasonality due to winter weather conditions;
- our ability to develop, introduce, patent, market and gain market acceptance of new products, applications and product enhancements in a timely manner, or at all;
- market acceptance of the products incorporating our technologies and products;
- the introduction of new products by competitors;
- the availability and cost of components used in the manufacture of our products;
- our success in expanding and implementing our sales and marketing programs;

- the effects of technological changes in our target markets;
- the amount of our backlog at any given time;
- the nature of our government contracts;
- deferrals of customer orders in anticipation of new products, applications or product enhancements;
- risks and uncertainties associated with our international business;
- currency fluctuations and our ability to get currency out of certain foreign countries; and
- general economic and political conditions; and
- international conflicts and acts of terrorism.

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

We have experienced a decline in our net sales and contract revenues over the last several quarters. If we fail to manage this decline effectively, we may be unable to execute our business plan and may experience future weaknesses in our operating results. We have expanded our overall business in the past few years; however, we experienced a reduction in our net sales and contract revenues over the last several quarters. Based on our business objectives, and in order to resume expanding, we will need to continue to add additional qualified personnel, and invest in additional research and development and sales and marketing activities. 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 manage these activities successfully, our growth, our business, our financial condition and our results of operations could continue to be adversely affected.

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

Litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation may also be necessary to defend against claims of infringement or invalidity by others. An adverse outcome in litigation or any similar proceedings could subject us to significant liabilities to third parties, require us to license disputed rights from others or require us to cease marketing or using certain products or technologies. We may not be able to obtain any licenses on terms acceptable to us, or at all. We also may have to indemnify certain customers or strategic partners if it is determined that we have infringed upon or misappropriated another party s intellectual property. Any of these results could adversely affect our business, financial condition and results of operations. In addition, the cost of addressing any intellectual property litigation claim, including legal fees and expenses, and the diversion of management s attention and resources, regardless of whether the claim is valid, could be significant and could seriously harm our business, financial condition and results of operations.

We have historically experienced substantial losses and may experience losses in the future. Although we have achieved net income in our past four fiscal years, we experienced a net loss of $11.3 million in the year ended March 31, 2005 and significant net losses in prior years. We cannot assure you that we will be able to sustain or improve our financial performance, or that we will be able to continue to achieve profitability on a quarterly or annual basis in the future. Most of our expenses are fixed in advance. As such, we generally are unable to reduce our expenses significantly in the short-term to compensate for any unexpected delay or decrease in anticipated revenues. As a result, we may 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.

The trading price of our common stock is highly volatile. The trading price of our common stock has been subject to wide fluctuations in the past. Since January 2001, our Class A common stock (now known as our common stock) has traded at prices as low as $0.45 per share and as high as $8.00 per share. The market price of our common stock could continue to fluctuate in the future in response to various factors, including, but not limited to:

- quarterly variations in operating results;
- our ability to control costs, improve cash flow and sustain profitability;
- our ability to raise additional capital;

- shortages announced by suppliers;
- announcements of technological innovations or new products or applications by our competitors, customers or us;
- transitions to new products or product enhancements;
- acquisitions of businesses, products or technologies;
- the impact of any litigation;
- changes in investor perceptions;
- government funding, political agendas and other budgetary constraints;
- changes in earnings estimates or investment recommendations by securities analysts; and
- international conflicts, political unrest and acts of terrorism.

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

We could experience negative financial impacts arising from developments in contingencies created under our previous structure or by former subsidiaries. Although we divested ourselves of all business units prior to October 2004, from time to time we could experience unforeseen developments in contingencies related to our former subsidiaries. For example, in July 2006 we entered into a settlement agreement in connection with a lawsuit brought against Mariner Networks, Inc., one of our former subsidiaries, by one of Mariner s suppliers, pursuant to which we issued 88,912 shares of our common stock to this supplier (valued at $213,000 as of the date of issuance) and paid $475,000 in cash. Although we are not aware of any other material contingencies, it is possible other matters could be brought against us in connection with activities related to former subsidiaries and that such matters could materially and adversely affect our financial results and cash flows.

Certain provisions of the Company s charter documents may discourage a third party from acquiring us and may adversely affect the price of our common stock. Certain provisions of our certificate of incorporation could make it difficult for a third party to acquire us, even though an acquisition might be beneficial to our stockholders. Such provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. Under the terms of our certificate of incorporation, our Board of Directors is authorized to issue, without stockholder approval, up to 2,000,000 shares of preferred stock with voting, conversion and other rights and preferences superior to those of our common stock. In addition, in August 2009, we adopted a 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 proxy contest more difficult.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

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

Exhibit Number	Description	Where Located
3.1	Restated Certificate of Incorporation of the registrant	*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*
3.2	Certificate of Designations of Series A Junior Participating Preferred Stock	*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*
3.3	Bylaws of registrant, as amended	*Exhibit 4.2 to the registrant s Registration Statement on Form S-1 (Reg. No. 033-67932) as filed with the SEC on July 6, 1993*
3.4	Certificates of Amendment to Bylaws of the registrant dated April 24, 1998 and August 10, 2001	*Exhibit 3.4 to the registrant s Annual Report on Form 10-K/A for the year ended March 31, 2003 as filed with the SEC on July 29, 2003*
3.5	Certificate of Amendment to Bylaws of registrant dated September 9, 2004	*Exhibit 3.1 to the registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 as filed with the SEC on November 15, 2004*
3.6	Certificate of Amendment to Bylaws of registrant dated September 16, 2005	*Exhibit 3.5 to the registrant s Annual Report on Form 10-K for the year ended March 31, 2007 as filed with the SEC on June 21, 2007*
3.7	Certificate of Amendment to Bylaws of registrant dated December 7, 2007	*Exhibit 3.1 to the registrant s Current Report on Form 8-K as filed with the SEC on December 13, 2007*
3.8	Certificate of Amendment to Bylaws of registrant, effective August 20, 2009	*Exhibit 3.3 to the registrant s Current Report on Form 8-K as filed with the SEC on August 21, 2009*
4.1	Specimen of Common Stock Certificate	*Exhibit 4.1 to the registrant s Amendment No. 1 to the Registration Statement on Form 8-A as filed with the SEC on December 8, 2004*
4.2	Rights Agreement dated August 20, 2009 between the registrant and Computershare Trust Company, N.A., including exhibits thereto	*Exhibit 4.1 to the registrant s Current Report on Form 8-K as filed with the SEC on August 21, 2009*
31.1	Certification of the Principal Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	*Filed herewith*
31.2	Certification of the Principal Financial and Accounting Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	*Filed herewith*
32.1	Certification of the Chief Executive Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	*Filed herewith*

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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: February 2, 2010	ITERIS, INC. (Registrant)	
	By	/S/ ABBAS MOHADDES Abbas Mohaddes Chief Executive Officer (Principal Executive Officer)
	By	/S/ JAMES S. MIELE James S. Miele Chief Financial Officer (Principal Financial and Accounting Officer)

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