
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended **December 31, 2010**

OR

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

For the transition period from to

Commission file number: **001-08762**



ITERIS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

1700 Carnegie 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 No

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of February 4, 2011, there were 34,337,756 shares of common stock outstanding.

ITERIS, INC.
Quarterly Report on Form 10-Q
For the Three and Nine Months Ended December 31, 2010

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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.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS**Iteris, Inc.**
Unaudited Condensed Consolidated Balance Sheets
(In thousands, except par value)

	<u>December 31,</u> <u>2010</u>	<u>March 31,</u> <u>2010</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 12,462	\$ 10,405
Trade accounts receivable	10,194	11,311
Costs in excess of billings on uncompleted contracts	3,588	3,871
Inventories	3,473	2,727
Deferred income taxes	4,870	4,993
Prepaid expenses and other current assets	504	623
Total current assets	<u>35,091</u>	<u>33,930</u>
Property and equipment, net	2,110	2,550
Deferred income taxes	9,739	9,739
Intangible assets, net	343	452
Goodwill	19,821	27,791
Other assets	204	200
Total assets	<u>\$ 67,308</u>	<u>\$ 74,662</u>
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	\$ 3,375	\$ 2,492
Accrued payroll and related expenses	2,618	2,709
Accrued liabilities	1,782	1,748
Billings in excess of costs and estimated earnings on uncompleted contracts	1,702	2,105
Current portion of long-term debt	2,324	2,324
Total current liabilities	<u>11,801</u>	<u>11,378</u>
Deferred rent	1,142	1,386
Unrecognized tax benefits	585	751
Other non-current liabilities	—	112
Long-term debt	1,097	2,969
Total liabilities	<u>14,625</u>	<u>16,596</u>
Commitments and contingencies		
Stockholders' equity:		
Common stock. \$0.10 par value, 70,000 shares authorized, 34,332 and 34,318 shares issued and outstanding at December 31, 2010 and March 31, 2010, respectively	3,433	3,432
Additional paid-in capital	137,807	137,503
Accumulated deficit	<u>(88,557)</u>	<u>(82,869)</u>
Total stockholders' equity	<u>52,683</u>	<u>58,066</u>
Total liabilities and stockholders' equity	<u>\$ 67,308</u>	<u>\$ 74,662</u>

See accompanying notes.

Iteris, Inc.
Unaudited Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
Net sales and contract revenues:				
Net sales	\$ 8,608	\$ 7,401	\$ 26,938	\$ 22,796
Contract revenues	5,424	6,176	16,854	20,280
Total net sales and contract revenues	14,032	13,577	43,792	43,076
Costs of net sales and contract revenues:				
Cost of net sales	4,352	3,844	13,415	12,099
Cost of contract revenues	3,929	4,198	11,308	13,290
Gross profit	5,751	5,535	19,069	17,687
Operating expenses:				
Selling, general and administrative	4,603	3,915	13,515	12,695
Research and development	882	890	2,863	2,738
Impairment of goodwill	7,970	—	7,970	—
Amortization of intangible assets	36	36	109	122
Total operating expenses	13,491	4,841	24,457	15,555
Operating income (loss)	(7,740)	694	(5,388)	2,132
Non-operating income (expense):				
Other income (expense), net	(7)	25	13	42
Interest expense, net	(38)	(58)	(120)	(215)
Income (loss) before income taxes	(7,785)	661	(5,495)	1,959
Benefit (provision) for income taxes	758	48	(193)	(563)
Net income (loss)	\$ (7,027)	\$ 709	\$ (5,688)	\$ 1,396
Net income (loss) per share:				
Basic	\$ (0.20)	\$ 0.02	\$ (0.17)	\$ 0.04
Diluted	\$ (0.20)	\$ 0.02	\$ (0.17)	\$ 0.04
Weighted average shares outstanding:				
Basic	34,332	34,260	34,331	34,235
Diluted	34,332	34,469	34,331	34,430

See accompanying notes.

Iteris, Inc.
Unaudited Condensed Consolidated Statements of Cash Flows
(In thousands)

	Nine Months Ended December 31,	
	2010	2009
Cash flows from operating activities		
Net income (loss)	\$ (5,688)	\$ 1,396
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in deferred tax assets	123	574
Depreciation of property and equipment	730	742
Stock-based compensation	286	282
Impairment of goodwill	7,970	—
Amortization of intangible assets	109	122
Loss on disposal of property and equipment	8	—
Changes in operating assets and liabilities:		
Accounts receivable	1,117	2,451
Net costs and estimated earnings in excess of billings	(120)	(368)
Inventories	(746)	2,478
Prepaid expenses and other assets	115	(196)
Accounts payable and accrued expenses	410	(2,569)
Net cash provided by operating activities	<u>4,314</u>	<u>4,912</u>
Cash flows from investing activities		
Purchases of property and equipment	(298)	(180)
Cash paid for business combination	—	(300)
Net cash used in investing activities	<u>(298)</u>	<u>(480)</u>
Cash flows from financing activities		
Borrowings on long-term debt	—	750
Payments on long-term debt	(1,872)	(2,293)
Deferred payment for prior business combination	(106)	—
Proceeds from stock option exercises	19	90
Net cash used in financing activities	<u>(1,959)</u>	<u>(1,453)</u>
Effect of exchange rate changes on cash	—	53
Increase in cash and cash equivalents	2,057	3,032
Cash and cash equivalents at beginning of period	10,405	6,372
Cash and cash equivalents at end of period	<u>\$ 12,462</u>	<u>\$ 9,404</u>
Supplemental disclosure of non-cash investing and financing activities:		
Liabilities incurred for business combination	\$ —	\$ 218

See accompanying notes.

Iteris, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements
December 31, 2010

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Iteris, Inc. (including our subsidiary, referred to collectively in these unaudited consolidated financial statements as “Iteris,” the “Company,” “we,” “our” and “us”) is a leader in the traffic management market focused on the development and application of advanced technologies that reduce traffic congestion and improve the safety of surface transportation systems infrastructure. Additionally, we believe our products and services, in conjunction with sound traffic management, minimize the environmental impact of traffic congestion. By combining outdoor image processing, traffic engineering and information technology, we offer a broad range of Intelligent Transportation Systems (“ITS”) and driver safety solutions. 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, 2010, the consolidated results of operations for the three and nine months ended December 31, 2010 and 2009 and the consolidated cash flows for the nine months ended December 31, 2010 and 2009. 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, 2010 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, 2010, which was filed with the SEC on May 21, 2010.

Use of Estimates

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

Revenue Recognition

Net Sales

Product revenues and related costs of sales are recognized 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.

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

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

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 \$163,000 and \$459,000 for the three and nine months ended December 31, 2010, respectively, and \$124,000 and \$563,000 for the three and nine months ended December 31, 2009, respectively.

Contract Revenues

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 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.

Foreign Currency

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

Concentration of Credit Risk

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

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

Our accounts receivable are primarily derived from revenues earned from customers located throughout North America and Europe. We generally do not require collateral or other security from customers. We maintain an allowance for doubtful accounts for potential credit losses, which losses have generally been within management’s expectations.

Fair Values of Financial Instruments

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

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Cash and Cash Equivalents

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

Allowance for Doubtful Accounts

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

Costs in Excess of Billings on Uncompleted Contracts

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

Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts

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

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

Inventories

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

Property and Equipment

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

Goodwill and Long-Lived Assets

Goodwill is tested for impairment on an annual basis in our fourth fiscal quarter or more frequently if indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of our reporting units with each respective reporting unit's carrying amount, including goodwill. We determine the fair value of reporting units using the income approach with a reconciliation of the total reporting unit fair value to our total market capitalization plus an appropriate control premium. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, the second step of the goodwill impairment test is performed to determine the amount of any impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill and an impairment charge is recorded for any excess carrying amount over fair value. We performed annual impairment assessments of the carrying value of goodwill for each of the fiscal years ended March 31, 2010, 2009 and 2008. 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. Various circumstances including, among others, certain adverse business conditions impacting one or more reporting units or a decline in our market capitalization for an extended period of time, would cause us to test goodwill for impairment on an interim basis. Refer to Note 4 for additional discussion regarding our interim goodwill impairment analyses.

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

Income Taxes

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

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

Stock-Based Compensation

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

Research and Development Expenditures

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

Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2009-13, *Multiple-Deliverable Revenue Arrangements* (“ASU 2009-13”), which amends the existing multiple-element revenue arrangements guidance currently included in Accounting Standards Codification (“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 adopted the amendments prescribed by ASU 2009-13 for our fiscal year beginning April 1, 2010 and such adoption did not 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* (“ASU 2009-14”), which amends and modifies the scope of ASC 985-605, *Software — Revenue Recognition*, such that many sales transactions of tangible products that include software and other related transactions will fall outside its scope. We adopted the amendments prescribed by ASU 2009-14 for our fiscal year beginning April 1, 2010 and such adoption did not have a material impact on our consolidated financial statements.

In December 2010, the FASB issued ASU No. 2010-29, *Disclosures of Supplementary Pro Forma Information for Business Combinations* (“ASU 2010-29”), which amends certain existing, and adds additional, pro forma disclosure requirements for public companies under ASC 805, *Business Combinations*. We expect to adopt the amendments prescribed in ASU 2010-29 for business combinations for which the acquisition date is on or after our fiscal year beginning April 1, 2011. We do not expect such adoption to have a material impact on our consolidated financial statements.

2. Supplemental Financial Information

Inventories

The following table presents details of our inventories:

	December 31, 2010	March 31, 2010
	(In thousands)	
Materials and supplies	\$ 2,609	\$ 2,292
Work in process	102	49
Finished goods	762	386
	<u>\$ 3,473</u>	<u>\$ 2,727</u>

Intangible Assets

The following table presents details of our intangible assets:

	December 31, 2010		March 31, 2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Intangible assets subject to amortization:				
Developed technology	\$ 996	\$ (670)	\$ 996	\$ (595)
Patents	317	(300)	317	(266)
Total	<u>\$ 1,313</u>	<u>\$ (970)</u>	<u>\$ 1,313</u>	<u>\$ (861)</u>

As of December 31, 2010, future estimated amortization expense is as follows:

<u>Year Ending March 31:</u>	
(In thousands)	
Remainder of 2011	\$ 37
2012	106
2013	100
2014	100
	<u>\$ 343</u>

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

Goodwill

The following table presents activity related to the carrying value of goodwill by reportable segment for the nine months ended December 31, 2010:

	<u>Roadway Sensors</u>	<u>Vehicle Sensors</u>	<u>Transportation Systems</u>	<u>Total</u>
	(In thousands)			
Beginning balance	\$ 8,214	\$ 4,671	\$ 14,906	\$ 27,791
Impairment of Transportation Systems goodwill (Note 4)	—	—	(7,970)	(7,970)
Ending balance	<u>\$ 8,214</u>	<u>\$ 4,671</u>	<u>\$ 6,936</u>	<u>\$ 19,821</u>

Warranty Reserve Activity

The following table presents activity related to the warranty reserve:

	<u>Nine Months Ended December 31,</u>	
	<u>2010</u>	<u>2009</u>
	(In thousands)	
Balance at beginning of period	\$ 467	\$ 582
Additions charged to cost of sales	125	102
Warranty claims	(138)	(141)
Balance at end of period	<u>\$ 454</u>	<u>\$ 543</u>

Net Income (Loss) Per Share

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

	<u>Three Months Ended December 31,</u>		<u>Nine Months Ended December 31,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(In thousands, except per share amounts)			
Numerator:				
Net income (loss)	<u>\$ (7,027)</u>	<u>\$ 709</u>	<u>\$ (5,688)</u>	<u>\$ 1,396</u>
Denominator:				
Weighted average common shares used in basic computation	34,332	34,260	34,331	34,235
Dilutive stock options	—	208	—	194
Dilutive warrants	—	1	—	1
Weighted average common shares used in diluted computation	<u>34,332</u>	<u>34,469</u>	<u>34,331</u>	<u>34,430</u>
Net income (loss) per share:				
Basic	<u>\$ (0.20)</u>	<u>\$ 0.02</u>	<u>\$ (0.17)</u>	<u>\$ 0.04</u>
Diluted	<u>\$ (0.20)</u>	<u>\$ 0.02</u>	<u>\$ (0.17)</u>	<u>\$ 0.04</u>

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The following instruments were excluded from the computation of diluted net income (loss) per share as their effect would have been anti-dilutive:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
	(In thousands)			
Stock options	3,173	1,095	1,690	2,043
Warrants	261	335	281	387
Restricted stock units	214	—	71	—

3. Fair Value Measurements

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

At December 31, 2010, we did not have any material financial assets or liabilities measured at fair value on a recurring basis using 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. Other than goodwill, which was measured using certain Level 3 inputs (see Note 4), no non-financial assets were measured at fair value during the three and nine months ended December 31, 2010 and 2009.

4. Impairment of Goodwill

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

As of September 30, 2010, we performed the first step in the impairment analysis of the carrying value of goodwill for all reporting units primarily due to the decline in our stock price and market capitalization since our fiscal year ended March 31, 2010 and the ongoing weakness in the current economic environment. This analysis did not result in any impairment charges during the quarter ended September 30, 2010.

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

The implied fair value of goodwill was determined in the same manner utilized to estimate the amount of goodwill recognized in a business combination. To determine this value, we estimated the fair value of the assets and liabilities, including certain intangible assets, to be allocated to the Transportation Systems reporting unit as of December 31, 2010. The implied fair value of goodwill was measured as the difference between the estimated fair value of the reporting unit over the estimated fair value amounts of its assets and liabilities. The impairment loss for the Transportation Systems reporting unit was measured by the amount the carrying value of its goodwill exceeded the implied fair value of the goodwill. Accordingly, in order to write down Transportation Systems goodwill with a carrying value of \$14.9 million to its implied fair value of \$6.9 million, we recorded an impairment charge of \$8.0 million in the three months ended December 31, 2010.

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

Notwithstanding the impairment charge with respect to our Transportation Systems reporting unit described above, based on our interim analyses, we do not believe there are indicators of interim impairment of the Roadway Sensors or Vehicle Sensors reporting units as of December 31, 2010. We plan to perform our annual test for impairment of the carrying value of goodwill during the fourth fiscal quarter of our current fiscal year ending March 31, 2011.

5. Revolving Line of Credit and Long-Term Debt

Revolving Line of Credit

In September 2010, we entered into a modification agreement with California Bank & Trust to extend the expiration date of our revolving line of credit to October 1, 2012. The terms under this agreement are substantially similar to those of our prior agreement, whereby we may borrow up to \$12.0 million on our revolving line of credit. 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, 2010) 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 our credit facility (which includes our bank term note discussed below). 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, 2010, no amounts were outstanding under the revolving line of credit portion of the facility.

Long-Term Debt — Bank Term Note

As of December 31, 2010, we had outstanding borrowings of approximately \$3.4 million under our 48-month term note with California Bank & Trust. 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, 2010 and March 31, 2010, an additional \$500,000 was included in the current portion of the term note within the accompanying unaudited condensed consolidated balance sheets, respectively representing the amount we estimate will be due on November 1, 2011 and the amount paid 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%, 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.

6. Income Taxes

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
	(In thousands, except percentages)			
Benefit (provision) for income taxes	\$ 758	\$ 48	\$ (193)	\$ (563)
Effective tax rate	(9.7)%	(7.3)%	3.5%	28.7%

During the three and nine months ended December 31, 2010, our effective tax rates were impacted unfavorably by a portion of the charge recorded for the impairment of goodwill (Note 4), amounting to approximately \$2.3 million, for which there is no corresponding tax basis. This unfavorable impact was partially offset by the impact of the recognition of approximately \$238,000 of previously unrecognized tax benefits during the current quarter due to the expiration of certain federal and state statutes in various jurisdictions. For the three and nine months ended December 31, 2009, our effective tax rates 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. We have not recorded any valuation allowance against our deferred tax assets as of December 31, 2010 and March 31, 2010.

7. Commitments and Contingencies

Litigation and Other Contingencies

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

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.

Related Party Transaction

In August 2009, MAXxess Systems, Inc. ("MAXxess") executed a promissory note payable to Iteris for \$274,000 for amounts previously owed to us under a sublease agreement for which we had previously fully reserved such amount. MAXxess is owned by an investor group that includes two of our directors. As of December 31, 2010, all accrued interest has been paid and the entire \$274,000 principal balance was outstanding and payable to Iteris and remains fully reserved.

8. Employee Benefit Plans

We currently administer three separate stock incentive plans. Of these plans, we may only grant future awards from the 2007 Omnibus Incentive Plan (the "2007 Plan"). The 2007 Plan allows for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units ("RSUs") and other stock-based awards. At December 31, 2010, there were 641,000 shares of common stock available for grant under the 2007 Plan.

Stock Options

A summary of activity with respect to our stock options for the nine months ended December 31, 2010 is as follows:

	<u>Number of Shares</u> (In thousands)	<u>Weighted Average Exercise Price per Share</u>
Options outstanding at March 31, 2010	3,218	\$ 1.77
Granted	30	1.45
Exercised	(14)	1.39
Expired	(63)	11.13
Options outstanding at December 31, 2010	<u>3,171</u>	<u>\$ 1.58</u>

Included in the options outstanding at December 31, 2010 are vested options to purchase 769,000 shares of our common stock with an exercise price per share of \$1.19, which are scheduled to expire in September 2011 unless exercised prior to that date.

Restricted Stock Units

In August 2010, we granted 214,000 RSUs under the 2007 Plan to certain employees of Iteris, all of which were unvested and outstanding as of December 31, 2010. These RSUs are stock awards that entitle the holder to receive registered shares of our common stock upon vesting. The RSUs vest at the rate of 25% per year beginning in August 2011. The fair value per share of these RSUs was \$1.48, determined based on the closing market price of our common stock on the grant date.

Stock-Based Compensation Expense

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
	(In thousands)			
Cost of net sales	\$ 3	\$ 3	\$ 8	\$ 7
Cost of contract revenues	9	10	26	30
Selling, general and administrative expense	78	75	227	225
Research and development expense	10	7	25	20
	<u>\$ 100</u>	<u>\$ 95</u>	<u>\$ 286</u>	<u>\$ 282</u>

At December 31, 2010, there was approximately \$719,000 of unrecognized compensation expense related to unvested stock options and RSUs. This expense is currently expected to be recognized over a weighted average period of approximately 2.6 years. If there are any modifications or cancellations of the underlying unvested awards, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that we grant additional stock options, RSUs or other stock-based awards.

The grant date fair value per share of stock options granted in the nine months ended December 31, 2010 has been estimated using the following weighted average assumptions:

Expected life - years	7
Risk-free interest rate	2.1%
Expected volatility of common stock	58%
Dividend yield	—
Weighted-average grant date fair value per share	<u>\$ 0.86</u>

9. Common Stock Warrants

The following table summarizes information regarding outstanding warrants to purchase shares of our common stock as of December 31, 2010:

Exercise Price per Share	Warrants Outstanding (In thousands)	Remaining Contractual Life (Years)
\$ 1.42	15	2.7
3.25	246	0.2
	<u>261</u>	

All of the outstanding warrants were exercisable at December 31, 2010.

10. 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 consolidated financial information for our reportable segments for the three and nine months ended December 31, 2010 and 2009:

	Roadway Sensors	Vehicle Sensors	Transportation Systems	Total
(In thousands)				
Three Months Ended December 31, 2010				
Product revenue	\$ 6,529	\$ 1,916	\$ —	\$ 8,445
Service and other revenue	—	163	5,424	5,587
Stock-based compensation	15	4	19	38
Depreciation and amortization	53	20	47	120
Impairment of goodwill	—	—	7,970	7,970
Segment income (loss)	797	(86)	(8,354)	(7,643)
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
Nine Months Ended December 31, 2010				
Product revenue	\$ 21,470	\$ 5,009	\$ —	\$ 26,479
Service and other revenue	—	459	16,854	17,313
Stock-based compensation	36	15	50	101
Depreciation and amortization	166	62	145	373
Impairment of goodwill	—	—	7,970	7,970
Segment income (loss)	3,377	(592)	(7,876)	(5,091)
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

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
(In thousands)				
Segment income (loss):				
Total income (loss) from reportable segments	\$ (7,643)	\$ 791	\$ (5,091)	\$ 2,423
Unallocated amounts:				
Corporate and other expenses	(61)	(61)	(188)	(169)
Amortization of intangible assets	(36)	(36)	(109)	(122)
Other income (expense), net	(7)	25	13	42
Interest expense, net	(38)	(58)	(120)	(215)
Income (loss) before income taxes	<u>\$ (7,785)</u>	<u>\$ 661</u>	<u>\$ (5,495)</u>	<u>\$ 1,959</u>

11. Subsequent Event

On January 3, 2011 (the “Closing”), we acquired all of the capital stock of Meridian Environmental Technology, Inc. (“MET”), a privately-held company based in Grand Forks, North Dakota. MET specializes in 511 advanced traveler information systems, as well as Maintenance Decision Support System management tools that allow users to create solutions to meet roadway maintenance decision needs. Our primary reasons for the acquisition were (i) to enhance our ability to provide travelers and traffic management authorities with more accurate and real-time information and network performance management tools and (ii) to provide Iteris with key capabilities in the emerging performance measurement and management market.

In connection with the acquisition, we paid approximately \$1.5 million in cash at the Closing, which is subject to certain post-closing adjustments pursuant to the stock purchase agreement. We also agreed to pay up to \$1 million on each of the first two anniversaries of the Closing, subject to certain adjustments related to the retention of various key employees and certain other adjustments as further defined in the agreement. Additionally, we may pay up to an additional \$1 million per year for two years pursuant to an earn-out provision, based on revenue and operating income achieved from MET’s operations during the twelve months ending December 31, 2011 and 2012. We are currently in the process of performing the initial accounting for this business combination, including measuring the fair value of the consideration transferred (including contingent consideration) and identifying and measuring the gross amount and fair value of the assets acquired and liabilities assumed, which we expect to complete in the quarter ending March 31, 2011. Supplemental pro forma information is not presented as the necessary analysis has not yet been performed on MET’s historical financial information.

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

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

Overview

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

Business Segments. We currently operate in three reportable segments: Roadway Sensors, Vehicle Sensors and Transportation Systems. The Roadway Sensors segment includes our Vantage, VersiCam and Pico vehicle detection systems for traffic intersection control, incident detection and certain highway traffic data collection applications, as well as our Abacus family of products. The Vehicle Sensors segment includes our lane departure warning (“LDW”) products, including our AutoVue LDW system, and is comprised of all of our activities related to in-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.

Roadway Sensors

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

- Our Vantage video detection systems detect vehicle presence at intersections, as well as vehicle count, speed and other traffic data used in traffic management systems. Our Vantage systems give traffic managers the ability to mitigate roadway congestion by modifying traffic signal timing or detecting incidents quickly.

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- VersiCam, our integrated camera and processor video detection system, is a cost-efficient video detection system for smaller intersections that require only a few detection points.
- Pico, our compact video detection system, was developed primarily to address international video detection needs, and was designed for easy installation and configuration.
- Our Abacus products take advantage of the large number of existing installed closed-circuit television video feeds monitoring roadways, signalized intersections, tunnels and bridges to allow for data collection and incident detection without the set-up and calibration generally required with other systems.

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

Vehicle Sensors

Our Vehicle Sensors segment addresses the leading cause of roadway fatalities: lane change, roadway departure and rear-end collision accidents. We developed the world's first production LDW system and offer a proven system that is available as an original equipment manufacturer ("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. We believe that as a result of the expected 2013 European Union ("EU") 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 affect our future LDW sales and margins. We are currently working with our 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. Recently, we and our partner have experienced a greater degree of competition in the passenger car market, as several passenger car OEMs have introduced vehicle platforms with competing LDW systems. However, Valeo continues to pursue opportunities in the passenger car market.

In addition to our LDW systems, our Vehicle Sensors portfolio includes radar-based Forward Collision Warning ("FCW") and Blind Spot Warning ("BSW") systems for the North American truck market, and our SafetyDirect product, a system that reports driver performance data captured by our LDW system, and has the ability to relay this data directly to fleet operators through integration with the truck's existing fleet communications system. We expect future revenues generated by our SafetyDirect product will be based on a subscription model, whereby we charge our customers a monthly fee based on the number of vehicles equipped with the product. 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 SafetyDirect 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.

Transportation Systems

Our Transportation Systems segment includes transportation engineering and consulting services focused on the planning, design, development and implementation of software-based systems that integrate sensors, video surveillance, computers, and advanced communications equipment to enable public agencies to monitor, control and direct traffic flow, assist in the quick dispatch of emergency crews and distribute real-time information about traffic conditions. Our services include planning, design and implementation of surface transportation infrastructure systems. We perform analysis and study goods movement, commercial vehicle operations, travel demand forecasting and systems engineering, and identify mitigation measures to reduce traffic congestion. Historically, these services and systems have primarily been sold to local, state and national transportation agencies in the United States under a broad range of fixed price and cost plus fixed fee contracts; however, in the fiscal year ended March 31, 2010 ("fiscal 2010"), we began work on our first two overseas contract awards and plan to pursue additional international opportunities for our Transportation Systems segment.

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

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Acquisitions. In January 2011, we acquired all of the capital stock of Meridian Environmental Technology, Inc. (“MET”), for an initial payment of approximately \$1.5 million. MET was a privately-held company based in Grand Forks, North Dakota, and specializes in 511 advanced traveler information systems, as well as Maintenance Decision Support System management tools that allow users to create solutions to meet roadway maintenance decision needs. We also agreed to pay up to \$1 million on each of the first two anniversaries of the closing of the acquisition, as well as up to an additional \$2 million under a 24-month earn-out provision. Refer to Note 11 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report for additional discussion on this acquisition.

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

Critical Accounting Policies and Estimates

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

The accounting policies that affect our more significant judgments and estimates used in the preparation of our unaudited condensed consolidated financial statements are those relating to revenue recognition, accounts receivable, inventory, goodwill, warranty, income taxes, and stock-based compensation. These policies are described in further detail in our Annual Report on Form 10-K for fiscal 2010. There have been no significant changes in our critical accounting policies and estimates during the nine months ended December 31, 2010 as compared to what was previously disclosed in our Annual Report on Form 10-K for fiscal 2010, except for our revenue recognition policy, which has been updated as follows:

Revenue Recognition. We record product revenues (net sales) and related costs of sales upon transfer of title, which is generally upon shipment or, if required, upon acceptance by the customer, provided that we believe collectibility of the net sales amount is reasonably assured. Accordingly, at the date revenue is recognized, the significant uncertainties concerning the sale have been resolved.

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

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

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We also derive revenue from the provision of specific non-recurring contract engineering services to our strategic partner, Valeo, related to our LDW systems, and royalties earned on unit sales of our LDW systems by Valeo to the passenger car market. Non-recurring contract engineering revenues are recognized in the period in which the related services are performed. Royalty revenues are recorded based on unit sales of our products by Valeo and are recognized in the period in which such sales occur. Non-recurring contract engineering revenues and royalty revenues are included in our net sales.

Revenues from follow-on service and support, for which we generally charge separately, are recorded in the period in which the services are performed and are included in our net sales.

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 using the percentage of completion method of accounting based on the relationship of costs incurred to total estimated costs. Any anticipated losses on contracts are charged to earnings when identified. Changes in job performance and estimated profitability, including those arising from contract penalty provisions and final contract settlements, may result in revisions to recognized 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. Under the percentage of completion method, recognition of profit is dependent upon the accuracy of a variety of estimates, including engineering progress, materials quantities, and achievement of milestones, incentives, penalty provisions, labor productivity, cost estimates and others. Such estimates are based on various professional judgments we make with respect to those factors and are subject to change as the project proceeds and new information becomes available.

Recent Accounting Pronouncements

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

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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,	
	2010	2009	2010	2009
Net sales and contract revenues:				
Net sales	61.3%	54.5%	61.5%	52.9%
Contract revenues	38.7	45.5	38.5	47.1
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	31.0	28.3	30.6	28.1
Cost of contract revenues	28.0	30.9	25.8	30.9
Gross profit	41.0	40.8	43.5	41.1
Operating expenses:				
Selling, general and administrative	32.8	28.8	30.9	29.5
Research and development	6.3	6.6	6.5	6.4
Impairment of goodwill	56.8	—	18.2	—
Amortization of intangible assets	0.3	0.3	0.2	0.3
Total operating expenses	96.1	35.7	55.8	36.1
Operating income (loss)	(55.2)	5.1	(12.3)	4.9
Non-operating income (expense):				
Other income (expense), net	(0.0)	0.2	0.0	0.1
Interest expense, net	(0.3)	(0.4)	(0.3)	(0.5)
Income (loss) before income taxes	(55.5)	4.9	(12.5)	4.5
Benefit (provision) for income taxes	5.4	0.4	(0.4)	(1.3)
Net income (loss)	(50.1)%	5.2%	(13.0)%	3.2%

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 revenues from our Transportation Systems segment, 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, 2010 and 2009:

	Three Months Ended December 31,		Increase (Decrease)	% Change
	2010	2009		
	(In thousands, except percentages)			
Roadway Sensors	\$ 6,529	\$ 5,734	\$ 795	13.9%
Vehicle Sensors	2,079	1,667	412	24.7
Net sales	8,608	7,401	1,207	16.3
Contract revenues	5,424	6,176	(752)	(12.2)
Total net sales and contract revenues	<u>\$ 14,032</u>	<u>\$ 13,577</u>	<u>\$ 455</u>	3.4%

	Nine Months Ended December 31,		Increase (Decrease)	% Change
	2010	2009		
	(In thousands, except percentages)			
Roadway Sensors	\$ 21,470	\$ 18,691	\$ 2,779	14.9%
Vehicle Sensors	5,468	4,105	1,363	33.2
Net sales	26,938	22,796	4,142	18.2
Contract revenues	16,854	20,280	(3,426)	(16.9)
Total net sales and contract revenues	<u>\$ 43,792</u>	<u>\$ 43,076</u>	<u>\$ 716</u>	1.7%

We have historically had a diverse customer base. For the nine months ended December 31, 2010 and 2009, no individual customer represented greater than 10% of our total net sales and contract revenues.

Roadway Sensors

The increases in Roadway Sensors net sales for the three and nine months ended December 31, 2010 as compared to the corresponding periods in the prior year were driven by higher unit sales domestically from both our direct sales and dealer markets which was offset in part by lower prices due to competitive pressures. In the current period, we also saw particular strength, both domestically and internationally, in certain of our newer product lines which were introduced within the last 12 to 18 months. Additionally, we believe we have recently gained market share as a result of these new product introductions. However, we cannot assure that these new products will continue to gain market share or new products we develop in the future will be as successful. In the prior year periods, especially in the first quarter, we experienced significantly lower sales primarily as a result of the downturn in the overall economy, which brought declines in commercial and residential construction, reductions and delays in spending on infrastructure projects and government budgetary pressures.

Vehicle Sensors

Vehicle Sensors net sales were primarily made up of sales of our LDW systems to the heavy truck market, which aggregated approximately \$1.9 million and \$5.0 million for the three and nine months ended December 31, 2010, respectively, compared to \$1.5 million and \$3.5 million for the three and nine months ended December 31, 2009, respectively. In the prior year, we experienced a significant slowdown in overall LDW unit shipments to each of our key markets, driven largely by the weakness in the U.S. and worldwide economy at that time. Comparatively, in the current year periods, we have seen relatively higher unit sales, particularly to our foreign OEM heavy truck customers in Europe and Japan, as well as to our domestic truck fleet customers. Although we have seen improvements in our sales in the current year, as compared to the prior year, we remain cautious in our outlook for the remainder of the current fiscal year and beyond. We anticipate that Vehicle Sensors unit sales in future periods could be adversely impacted by, among other factors, slower than expected adoption rates of our LDW system across each of our target markets and the continuing uncertainty in the global economic environment. Additionally, future unit sales of LDW systems and unit pricing could be adversely impacted as a result of increased competition in this market.

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 \$163,000 and \$459,000 for the three and nine months ended December 31, 2010, respectively, compared to \$124,000 and \$563,000 for the three and nine months ended December 31, 2009, respectively. The net overall decline in the current fiscal year was primarily the result of continued decreases 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. The decrease in contract engineering services provided was partially offset by an increase in our royalty revenues in the current fiscal year as compared to the prior fiscal year. Our LDW systems are currently offered as an option on four Infiniti models. While Valeo is promoting our LDW systems to other passenger car OEMs, we cannot assure you that Valeo will be successful in these efforts.

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Contract Revenues

Contract revenues are primarily dependent upon the continued availability of funding at the local, state and federal levels from the various agencies and departments of transportation. For the three and nine months ended December 31, 2010, the decrease in our contract revenues compared to the corresponding periods in the prior year was primarily the result of the ongoing weakness in the Transportation Systems markets, which has been aggravated by a general lengthening of the overall sales cycle, from the bid and proposal process, to the signing of a contract and commencement of work on a project, as well as government budgeting constraints and funding delays on certain existing contracts. In the prior year periods, we experienced higher revenues from several large contracts which also contained higher than usual amounts of sub-consulting content. 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.

Gross Profit. The following tables present details of our gross profit for the three and nine months ended December 31, 2010 and 2009:

	Three Months Ended		Increase	% Change
	December 31,			
	2010	2009		
	(In thousands, except percentages)			
Total gross profit	\$ 5,751	\$ 5,535	\$ 216	3.9%
Total gross profit as a % of total net sales and contract revenues	41.0%	40.8%		
Gross profit as a % of net sales	49.4%	48.1%		
Gross profit as a % of contract revenues	27.6%	32.0%		

	Nine Months Ended		Increase	% Change
	December 31,			
	2010	2009		
	(In thousands, except percentages)			
Total gross profit	\$ 19,069	\$ 17,687	\$ 1,382	7.8%
Total gross profit as a % of total net sales and contract revenues	43.5%	41.1%		
Gross profit as a % of net sales	50.2%	46.9%		
Gross profit as a % of contract revenues	32.9%	34.5%		

Our total gross profit and total gross profit as a percent of total net sales and contract revenues increased for the nine months ended December 31, 2010 as compared to the corresponding period in the prior year primarily as a result of our product and service mix, whereby product net sales represented approximately 62% of our total net sales and contract revenues in the current period as compared to only 53% in the prior year period. Our product net sales generally carry higher margins than our contract revenues derived from our consulting services.

The increase in gross profit as a percent of net sales (“gross margin”) for the three and nine months ended December 31, 2010 as compared to the corresponding periods in the prior year was primarily a result of higher overall net sales and margins in Roadway Sensors during the current year. Such higher margins were largely driven by our customer mix and lower costs for certain key materials. We generally enjoy higher gross margins on direct sales as compared to dealer and aftermarket sales. In Vehicle Sensors, we also experienced a significant improvement in our year over year gross margins as a result of both (i) overall higher product sales levels in the current period which provided for improved overhead absorption and (ii) higher royalty revenues from Valeo. Additionally, in the prior year periods, we recorded certain estimates for excess and obsolete inventory in our Vehicle Sensors segment, which adversely affected our gross margins in that period. 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. Gross profit as a percent of contract revenues for the three months ended December 31, 2010 was down considerably from the comparable prior year period primarily due to lower overall revenues in the current quarter, as well as the result of various paid holidays during the current quarter. In the current nine month period, gross profit as a percent of contract revenues was slightly lower than the prior year period primarily due to the effects from the current three month period described directly above. We expect the variability and related timing of contract mix and related sub-consulting content in our Transportation Systems contracts in future periods, as well as paid holidays and other factors, will continue to cause fluctuations in this segment's gross margins from period to period.

Selling, General and Administrative Expense. The following tables present selling, general and administrative expense for the three and nine months ended December 31, 2010 and 2009:

	<u>Three Months Ended December 31, 2010</u>		<u>Three Months Ended December 31, 2009</u>		<u>Increase (Decrease)</u>	<u>% Change</u>
	<u>Amount</u>	<u>% of Net Sales and Contract Revenues</u>	<u>Amount</u>	<u>% of Net Sales and Contract Revenues</u>		
	(In thousands, except percentages)					
Salary and personnel-related	\$ 3,134	22.3%	\$ 2,611	19.2%	\$ 523	20.0%
Facilities, insurance and supplies	532	3.8	436	3.2	96	22.0
Travel and conferences	421	3.0	346	2.5	75	21.7
Professional and outside services	337	2.4	205	1.5	132	64.4
Other	179	1.3	317	2.3	(138)	(43.5)
Selling, general and administrative	<u>\$ 4,603</u>	<u>32.8%</u>	<u>\$ 3,915</u>	<u>28.8%</u>	<u>\$ 688</u>	<u>17.6%</u>
	<u>Nine Months Ended December 31, 2010</u>		<u>Nine Months Ended December 31, 2009</u>		<u>Increase (Decrease)</u>	<u>% Change</u>
	<u>Amount</u>	<u>% of Net Sales and Contract Revenues</u>	<u>Amount</u>	<u>% of Net Sales and Contract Revenues</u>		
	(In thousands, except percentages)					
Salary and personnel-related	\$ 9,368	21.4%	\$ 8,518	19.8%	\$ 850	10.0%
Facilities, insurance and supplies	1,747	4.0	1,708	4.0	39	2.3
Travel and conferences	1,166	2.7	1,042	2.4	124	11.9
Professional and outside services	1,063	2.4	794	1.8	269	33.9
Other	171	0.4	633	1.5	(462)	(73.0)
Selling, general and administrative	<u>\$ 13,515</u>	<u>30.9%</u>	<u>\$ 12,695</u>	<u>29.5%</u>	<u>\$ 820</u>	<u>6.5%</u>

The overall increase in selling, general and administrative expense for the three and nine months ended December 31, 2010 compared to the corresponding periods in the prior year was primarily due to (i) higher selling and commission-related expenses for our Roadway Sensors and Vehicle Sensors segments, as total net sales for both segments collectively increased approximately 16% and 18%, respectively, from the prior year periods, (ii) higher salary and headcount-related expenses as we have added certain key sales and marketing personnel in all three of our business segments, (iii) additional consulting and outside services expenses in the Vehicle Sensors segment related to market research and certain other sales and marketing activities and (iv) additional legal and professional services related to our acquisition of MET, along with various other corporate initiatives. We also saw a shift from cost of sales to sales and marketing of certain of our headcount expenses in our Transportation Systems segment in the current year commensurate with the overall decline in this segment's revenues and the reallocation of existing personnel in an effort to expand our contract backlog and increase contract revenues. However, we cannot assure that our efforts will be successful. Additionally, in the nine months ended December 31, 2010, we realized approximately \$250,000 in reversals of previously recorded bad debt expense (included in the "Other" category in the table above) as a result of collecting certain large accounts receivable balances. In prior periods, we had recorded an estimated allowance for doubtful accounts against these receivables given the uncertainty of collection at that time. In the future, our operating results in any given period may be favorably or adversely impacted as a result of our estimates of the realization of our accounts receivable. We currently expect our total selling, general and administrative expenses for the current fiscal year and future periods to be higher in absolute dollars when compared to recent prior year periods mainly as a result of our company-wide efforts to expand our Roadway Sensors net sales and Transportation Systems contract revenues, both domestically and internationally, and gain market share.

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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, 2010 and 2009:

	<u>Three Months Ended December 31, 2010</u>		<u>Three Months Ended December 31, 2009</u>		<u>Increase (Decrease)</u>	<u>% Change</u>
	<u>Amount</u>	<u>% of Net Sales and Contract Revenues</u>	<u>Amount</u>	<u>% of Net Sales and Contract Revenues</u>		
	(In thousands, except percentages)					
Salary and personnel-related	\$ 562	4.0%	\$ 613	4.5%	\$ (51)	(8.3)%
Facilities, development and supplies	239	1.7	245	1.8	(6)	(2.4)
Other	81	0.6	32	0.2	49	153.1
Research and development	<u>\$ 882</u>	<u>6.3%</u>	<u>\$ 890</u>	<u>6.6%</u>	<u>\$ (8)</u>	<u>(0.9)%</u>
	<u>Nine Months Ended December 31, 2010</u>		<u>Nine Months Ended December 31, 2009</u>		<u>Increase (Decrease)</u>	<u>% Change</u>
	<u>Amount</u>	<u>% of Net Sales and Contract Revenues</u>	<u>Amount</u>	<u>% of Net Sales and Contract Revenues</u>		
	(In thousands, except percentages)					
Salary and personnel-related	\$ 1,778	4.1%	\$ 1,957	4.5%	\$ (179)	(9.1)%
Facilities, development and supplies	920	2.1	676	1.6	244	36.1
Other	165	0.4	105	0.2	60	57.1
Research and development	<u>\$ 2,863</u>	<u>6.5%</u>	<u>\$ 2,738</u>	<u>6.4%</u>	<u>\$ 125</u>	<u>4.6%</u>

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Research and development expenses for the nine months ended December 31, 2010 were, in total, higher than for the corresponding period in the prior year due primarily due to additional development and related activities associated with our Vehicle Sensors segment. We currently expect our total research and development expenditures for the current fiscal year will be slightly higher when compared to the prior fiscal year.

Impairment of Goodwill. As discussed in Note 1 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this report, goodwill is tested for impairment on an annual basis in our fourth fiscal quarter or more frequently if indicators of impairment exist.

As of September 30, 2010, we performed the first step in the impairment analysis of the carrying value of goodwill for all reporting units primarily due to the decline in our stock price and market capitalization since our fiscal year ended March 31, 2010 and the ongoing weakness in the current economic environment. This analysis did not result in any impairment charges during the quarter ended September 30, 2010.

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

The implied fair value of goodwill was determined in the same manner utilized to estimate the amount of goodwill recognized in a business combination. To determine this value, we estimated the fair value of the assets and liabilities, including certain intangible assets, to be allocated to the Transportation Systems reporting unit as of December 31, 2010. The implied fair value of goodwill was measured as the difference between the estimated fair value of the reporting unit over the estimated fair value amounts of its assets and liabilities. The impairment loss for the Transportation Systems reporting unit was measured by the amount the carrying value of its goodwill exceeded the implied fair value of the goodwill. Accordingly, in order to write down Transportation Systems goodwill with a carrying value of \$14.9 million to its implied fair value of \$6.9 million, we recorded an impairment charge of \$8.0 million in the three months ended December 31, 2010.

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

Our Transportation Systems segment has recently been adversely impacted by, among other factors, (i) continued delays in government spending and resolution of budgetary issues, (ii) longer than expected lead times in bidding, successfully winning and commencing work on new contracts, and renewing existing contracts, and (iii) the ongoing weakness in the macroeconomic environment and the longer than expected economic recovery. In the future, the value of goodwill attributable to our Transportation Systems or other reporting units could be adversely impacted by, among other factors, declines in our financial results or market capitalization for an extended period of time, or our failure to meet financial performance projections included in our forecasts of future operating results.

Notwithstanding the impairment charge with respect to our Transportation Systems reporting unit described above, based on our interim analyses, we do not believe there are indicators of interim impairment of the Roadway Sensors or Vehicle Sensors reporting units as of December 31, 2010. We plan to perform our annual test for impairment of the carrying value of goodwill during the fourth fiscal quarter of our current fiscal year ending March 31, 2011.

Interest Expense, Net. Net interest expense of \$38,000 and \$120,000 for the three and nine months ended December 31, 2010, respectively, was lower than the \$58,000 and \$215,000 for the three and nine months ended December 31, 2009, respectively, due to the overall lower level of borrowings in the current fiscal year, as we continue to make monthly principal payments on our term note. We currently anticipate our interest expense will continue to decline for the remainder of the fiscal year ending March 31, 2011. See "Liquidity and Capital Resources" below for additional details on our borrowings.

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Income Taxes. The following tables present our provision for income taxes for the three and nine months ended December 31, 2010 and 2009:

	Three Months Ended December 31,				% Change
	2010	2009	Increase		
	(In thousands, except percentages)				
Benefit (provision) for income taxes	\$ 758	\$ 48	\$ 710		1,479%
Effective tax rate	(9.7)%	(7.3)%			

	Nine Months Ended December 31,				% Change
	2010	2009	Decrease		
	(In thousands, except percentages)				
Benefit (provision) for income taxes	\$ (193)	\$ (563)	\$ 370		(66)%
Effective tax rate	3.5%	28.7%			

During the three and nine months ended December 31, 2010, our effective tax rates were impacted unfavorably by a portion of the charge recorded for the impairment of goodwill, amounting to approximately \$2.3 million, for which there is no corresponding tax basis. This unfavorable impact was partially offset by the impact of the recognition of approximately \$238,000 of previously unrecognized tax benefits during the current quarter due to the expiration of certain federal and state statutes in various jurisdictions. For the three and nine months ended December 31, 2009, our effective tax rates 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. We have not recorded any valuation allowance against our deferred tax assets as of December 31, 2010 and March 31, 2010.

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 to be sufficient to fund our operations for at least the next twelve months. However, we may need or choose to raise additional capital to fund potential future acquisitions and our future growth. We may raise such funds by selling equity or debt securities to the public or to selected investors, or by borrowing money from financial institutions. If we raise additional funds by issuing equity or convertible debt securities, our existing stockholders may experience significant dilution and any equity securities that may be issued may have rights senior to our existing stockholders.

At December 31, 2010, we had \$23.3 million in working capital, which included no borrowings on our \$12.0 million line of credit and \$12.5 million in cash and cash equivalents. This compares to working capital of \$22.6 million at March 31, 2010, which included no borrowings on our line of credit and \$10.4 million in cash and cash equivalents.

The following table summarizes our cash flows for the nine months ended December 31, 2010 and 2009:

	Nine Months Ended December 31,	
	2010	2009
	(In thousands)	
Net cash provided by (used in):		
Operating activities	\$ 4,314	\$ 4,912
Investing activities	(298)	(480)
Financing activities	(1,959)	(1,453)

Operating Activities. Cash provided by our operations for the nine months ended December 31, 2010 was the result of our net loss of \$5.7 million, which was offset by (i) \$9.2 million in non-cash items within the statement of operations, primarily \$8.0 million for the impairment of goodwill and depreciation expense of \$730,000; and (ii) \$776,000 in cash resulting from changes in our operating assets and liabilities during the period. Cash provided by operating activities during the nine months ended December 31, 2009 was primarily the result of (i) our net income during that period of \$1.4 million; (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 operating assets and liabilities during the period.

Our net accounts receivable decreased approximately \$1.1 million, or 10%, from March 31, 2010 to December 31, 2010 due primarily to (i) lower overall net sales and contract revenues in the current fiscal year, driven by lower Transportation Systems contract revenues and (ii) larger than expected cash collections near the end of the current quarter.

Our inventories increased approximately 27% from March 31, 2010 to December 31, 2010 as we have built up certain inventories on hand to meet anticipated increases in our product net sales in both Roadway Sensors and Vehicle Sensors. In the future, our inventory levels are likely to continue to be determined based upon, among other factors, the level of purchase orders we receive from our customers, the stage at which our products are in their respective product life cycles, and competitive situations in the marketplace. We attempt to balance such considerations against risk of obsolescence and potentially excess inventory levels.

The increase in accounts payable by approximately 35% from March 31, 2010 to December 31, 2010 was driven by our increased inventory levels and the general timing of payments to vendors.

Investing Activities. Cash used in our investing activities during the nine months ended December 31, 2010 consisted of \$298,000 for purchases of property and equipment. Cash used in 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 Hamilton Signal acquisition in April 2009.

Financing Activities. Net cash used in financing activities during the nine months ended December 31, 2010 was the result of (i) \$1.9 million in payments on our long-term debt and (ii) \$106,000 representing the first anniversary payment for the acquisition of certain assets of Hamilton Signal. These payments were partially offset during the period by \$19,000 in proceeds received from the exercise of outstanding stock options to purchase shares of our common stock. In April 2011, we expect to make the final payment of \$112,000 related to the Hamilton Signal acquisition. During the nine months ended December 31, 2009, cash used in financing activities was the result of net payments on our long-term debt of \$1.5 million, partially offset by \$90,000 in proceeds received from the exercise of outstanding stock options to purchase shares of our common stock.

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Borrowings

In October 2008, we entered into a \$19.5 million credit facility with California Bank & Trust (the “Bank”), 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). In September 2010, we entered into a modification agreement with the Bank to extend the expiration date of our revolving line of credit to October 1, 2012. 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, 2010) 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, 2010, no amounts were outstanding under the revolving line of credit portion of the facility. Availability under this line of credit may be reduced or otherwise limited as a result of our obligations to comply with certain financial covenants, as described further below.

As of December 31, 2010, we had outstanding borrowings of approximately \$3.4 million under the term note included in our credit facility. 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 loan agreement. These additional principal payments effectively reduce the total number of monthly installments necessary to repay the term note. To date, we have made additional principal payments of \$500,000 on November 1, 2010 and 2009, respectively. Interest on the term note is payable monthly at a rate equal to the current stated prime rate plus 0.50% up to the current stated prime rate plus 1.00%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. The term note contains no early termination fees and, along with 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 the Bank, we are also required to comply with certain quarterly financial covenants. These include achieving ratios for working capital and debt service, as well as maintaining a level of profitability, all of which are further defined in the agreement. While we believe we are currently in compliance with all such financial covenants, we cannot assure you that we will not violate one or more covenants in the future. If we were to be in violation of covenants under this agreement, our lender could choose to accelerate payment on all outstanding loan balances and pursue its security interest in our assets. In this event, we cannot assure you that we would be able to quickly obtain equivalent or suitable replacement financing on acceptable terms, on a timely basis, or at all. If we were not able to secure alternative sources of financing, such acceleration would have a material adverse impact on our business and financial condition.

Off Balance Sheet Arrangements

Other than our operating leases, we do not believe we have any other material off balance sheet arrangements at December 31, 2010.

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

Interest Rate 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 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.

Foreign Currency Risk

To date, a small portion of our net sales have been denominated in Euros. Gains or losses from foreign currency remeasurement are included in other income (expense), net in our consolidated financial statements and to date have not been significant. We do not believe we are currently exposed to any material risk of loss from currency exchange fluctuations. We do not currently purchase derivative financial instruments to hedge foreign currency exchange risk, but may do so in the future.

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.

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 7 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 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 reduced and delayed government funding for transportation infrastructure projects and initiatives, decreased availability of financial capital for our customers and has adversely impacted real estate development, all of which has adversely impacted our net sales and 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 in the prior fiscal year resulted in flat or declining Roadway Sensor and Vehicle Sensor net sales and also adversely impacted Transportation Systems contract revenues. Any of the foregoing economic conditions may adversely affect our net sales and contract revenues in future periods and make it extremely difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. Additionally, there continues to be uncertainties regarding the impact of the federal stimulus package and the fact that the accessibility of funds is taking longer than originally anticipated, as well as a delay in the passage of a new Federal Highway Bill. 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%, 45% and 38% of our total net sales and contract revenues for the fiscal years ended March 31, 2010, 2009 and 2008, 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 and other state and local funding dedicated for transportation projects;
- other government budgetary constraints, cut-backs, delays or reallocation of government funding;
- performance bond requirements;
- long purchase cycles or approval processes;
- competitive bidding and qualification requirements;
- changes in government policies and political agendas;
- milestone requirements and liquidated damage provisions for failure to meet contract milestones; and
- international conflicts or other military operations that could cause the temporary or permanent diversion of government funding from transportation or other infrastructure projects.

Governmental budgets and plans are subject to change without warning. Certain risks of selling to governmental entities include dependence on appropriations and administrative allocation of funds, changes in governmental procurement legislation and regulations and other policies that may reflect political developments or agendas, significant changes in contract scheduling, intense competition for government business and termination of purchase decisions for the convenience of the governmental entity. Substantial delays in purchase decisions by governmental entities, and the current constraints on government budgets at the federal, state and local level, could cause our 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 period. Our inability to address any of the foregoing concerns or the loss or renegotiation of any material government contract could seriously harm our business, financial condition and results of operations.

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

In Vehicle Sensors, 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, 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 a loss of market share, price reductions and reduced gross margins, any of which could seriously harm our business, financial condition and results of operations. Additionally, 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.

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

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

We 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. In January 2011, we completed the acquisition of Meridian Environmental Technology, Inc. We also completed the acquisition of certain assets of Hamilton Signal in April 2009. We have in the past acquired, and may in the future acquire, additional complementary businesses, products, and technologies. Acquisitions may require significant capital infusions and, in general, acquisitions also involve a number of special risks, including:

- potential disruption of our ongoing business and the diversion of our resources and management's attention;
- the failure to retain or integrate key acquired personnel;
- the challenge of assimilating diverse business cultures, and the difficulties in integrating the operations, technologies and information system of the acquired companies;
- increased costs to improve managerial, operational, financial and administrative systems and to eliminate duplicative services;
- the incurrence of unforeseen obligations or liabilities;

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

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

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

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

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

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

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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.

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.

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, our ability to 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.

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 passenger 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 pressures in the marketplace as technologies mature;

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- 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.

Our international business operations may be threatened by many factors that are outside of our control. While we historically have had limited international sales and operations experience, we began work on our first overseas contracts in Abu Dhabi and Dubai in fiscal 2010. We plan to expand our international efforts in the future with respect to all three of our segments, but cannot assure you that we will be successful in those efforts. International operations subject us to various inherent risks including, among others:

- currency fluctuations and restrictions;
- political, social and economic instability, as well as international conflicts and acts of terrorism;
- 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.

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

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

If our internal controls over financial reporting do not comply with the requirements of the Sarbanes-Oxley Act, our business and stock price could be adversely affected. Section 404 of the Sarbanes-Oxley Act of 2002 currently requires us to evaluate the effectiveness of our internal controls over financial reporting at the end of each fiscal year and to include a management report assessing the effectiveness of our internal controls over financial reporting in all annual reports.

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In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Section 989G of the Act added Section 404(c) to the Sarbanes-Oxley Act of 2002, which permanently exempts small public companies that qualify as either a Non-Accelerated Filer or Smaller Reporting Company from the auditor attestation requirement of Section 404(b) of the Sarbanes-Oxley Act. Likewise, in September 2010, the SEC issued a Final Rule, *Internal Control Over Financial Reporting in Exchange Act Periodic Reports for Non-Accelerated Filers*, to conform its rules and forms with the new Section 404(c). For our fiscal year ending March 31, 2011, we will be exempt from the auditor attestation requirement over our internal control over financial reporting; however, to the extent we do not qualify as a Non-Accelerated Filer or Smaller Reporting Company in subsequent fiscal years, we will be subject to such auditor attestation requirement. In such an event, we may not be able to complete the work required for such attestation on a timely basis, and even if we timely complete such requirements, our independent registered public accounting firm may still conclude that our internal controls over financial reporting are not effective.

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

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;
- our ability to access stimulus funding, funding from a new Federal Highway Bill or other funding;
- declines in new home and commercial real estate construction and related road and other infrastructure construction;
- changes in our pricing policies and the pricing policies of our suppliers and competitors, pricing concessions on volume sales, as well as increased price competition in general;
- the long lead times associated with government contracts 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;

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- 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.

As compared to recent prior fiscal years, we experienced a decline in our net sales and contract revenues in our most recently completed fiscal year ended March 31, 2010. 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 in the fiscal year ended March 31, 2010. Based on our business objectives, and in order to achieve future growth, we will need to continue to add additional qualified personnel, and invest in additional research and development and sales and marketing activities, which could lead to increases in our expenses and further declines in our operating results. In addition, our past expansion has placed, and future expansion is expected to place, a significant strain on our managerial, administrative, operational, financial and other resources. If we are unable to manage these activities or any unexpected revenue declines successfully, our growth, our business, our financial condition and our results of operations could continue to be adversely affected.

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

Litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation may also be necessary to defend against claims of infringement or invalidity by others. An adverse outcome in litigation or any similar proceedings could subject us to significant liabilities to third parties, require us to license disputed rights from others or require us to cease marketing or using certain products or technologies. We may not be able to obtain any licenses on terms acceptable to us, or at all. We also may have to indemnify 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 may need to raise additional capital in the future, which may not be available on terms acceptable to us, or at all. We have historically experienced volatility in our earnings and cash flows from operations from year to year. Although we have a \$12.0 million revolving line of credit, should we have an event of default, which includes, among other things, a failure to meet certain financial covenants and a material adverse change in the business, the bank could choose to limit or take away our ability to borrow these or any funds. Should this occur, or if the credit markets further tighten or our business declines, we may need or choose to raise additional capital to repay indebtedness, or pursue acquisitions or to expand our operations. Such additional capital may be raised through bank borrowings, or other debt or equity financings. We cannot assure you that any additional capital will be available on a timely basis, on acceptable terms, or at all, and such additional financing may result in further dilution to our stockholders.

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

- market acceptance of our products and product enhancements, and the overall level of sales of our products;
- our ability to control costs;
- the supply of key components for our products;
- our ability to increase revenue and net income;
- increased research and development expenses and sales and marketing expenses;
- our need to respond to technological advancements and our competitors' introductions of new products or technologies;
- capital improvements to new and existing facilities and enhancements to our infrastructure and systems;
- potential acquisitions of businesses and product lines;
- our relationships with customers and suppliers;
- government budgets, political agendas and other funding issues, including potential delays in government contract awards;
- our ability to successfully negotiate credit arrangements with our bank and the state of the financial markets, in general; and
- general economic conditions, including the effects of the current economic slowdown and international conflicts.

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

We may be unable to maintain profitability on a quarterly or annual basis. We cannot assure you that we will be able to sustain or improve our financial performance, or that we will be able to continue to achieve profitability on a quarterly or annual basis in the future. Our ability to maintain profitability in future periods could be impacted by budgetary constraints, government and political agendas, economic instability and other items that are not in our control. 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.

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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.

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

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

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following exhibits are filed herewith.

Exhibit Number	Description
2.1†	Stock Purchase Agreement dated December 23, 2010 by and among Iteris, Inc., Meridian Environmental Technology, Inc., the shareholders of MET and Kathy J. Osborne as the Shareholders Representative
31.1	Certification of the Principal Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Principal Financial and Accounting Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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

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 14, 2011

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)

Exhibit Index

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STOCK PURCHASE AGREEMENT

THIS STOCK PURCHASE AGREEMENT (this “**Agreement**”), dated as of December 23, 2010, is made and entered into by and among Iteris, Inc., a Delaware corporation having a principal address at 1700 Carnegie Avenue, Suite 100, Santa Ana, CA 92705 (the “**Buyer**”), Meridian Environmental Technology, Inc., a North Dakota corporation having a principal address at 4324 University Avenue, Suite B, Grand Forks, ND 58203 (the “**Company**”), Kathy J. Osborne, Leon F. Osborne, Jr., Mark Owens, Bryan Hahn, John Mewes, Cory Block (each an “**Individual Seller**” and collectively, the “**Individual Sellers**”), and The UND Aerospace Foundation, (“**UNDAF**” or “**Public Seller**”) (each of the Individual Sellers and Public Seller a “**Seller**” and collectively, “**Sellers**”), and Kathy J. Osborne, as the Shareholders Representative.

W I T N E S S E T H:

WHEREAS, the Company is engaged, among other things, in a business consisting of (i) the development, distribution, and management of atmospheric and Earth sciences information and technology, (ii) the development, implementation and operation of maintenance decision support systems for roadways (“**MDSS**”) and (iii) the development, implementation, and operation of advanced transportation information services (“**ATIS**”) including traveler information and 511 systems, and of providing related research and consulting services (collectively, the “**Business**”);

WHEREAS, Grand Forks Job Development Authority (“**GFJDA**”) owns 9,740 shares of Common Stock, no par value per share, of the Company (the “**GFJDA Shares**”);

WHEREAS, Sellers and GFJDA collectively own all of the issued and outstanding shares of capital stock of the Company, consisting of 277,130 shares of Common Stock, no par value per share, of the Company (the “**Shares**”);

WHEREAS, the Company and GFJDA plan to enter into that certain Stock Redemption Agreement, attached hereto as Exhibit A (the “**Redemption Agreement**”) pursuant to which the Company will purchase the GFJDA shares in exchange for (i) \$100,000 upon the consummation of the transaction contemplated by the Redemption Agreement (the “**GFJDA Closing Payment**”), plus (ii) any amounts in excess of \$100,000 which GFJDA would have received in connection with the sale of the GFJDA Shares in connection with this Agreement (the “**GFJDA Contingent Payments**”), with the GFJDA Contingent Payments to be paid by the Company if and when the same would have been paid by the Purchaser under this Agreement;

WHEREAS, immediately after consummation of the transactions contemplated by the Redemption Agreement, the Sellers shall own all of the issued and outstanding shares of the capital stock of the Company, consisting of 266,900 Shares; and

WHEREAS, on the terms and subject to the conditions set forth herein, Buyer desires to purchase from Sellers and Sellers desire to sell to Buyer, all of the Shares in exchange for the Aggregate Purchase Price (as defined in Section 1.2).

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements herein set forth, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby covenant and agree as follows:

1. PURCHASE AND SALE OF SHARES; CLOSING.

1.1 Purchase and Sale of Shares. Subject to and in accordance with the terms and conditions set forth in this Agreement, at the Closing, Sellers shall sell and deliver to Buyer, free and clear of any Liens, the Shares and Buyer shall deliver to the Sellers the Closing Cash Payment (the “**Purchase**”).

1.2 Purchase Price. The purchase price for the Shares shall be an amount equal to the sum of the following (collectively, “**Aggregate Purchase Price**”):

(a) Two Million Dollars (\$2,000,000) adjusted as follows: (i) reduced by the amount of any Company Indebtedness (as defined below); (ii) reduced by the amount by which the sum of cash and accounts receivable at the Closing is less than \$1,600,000 and will be increased by the exact amount (if any) that the sum of cash and accounts receivable is more than \$1,600,000; (iii) reduced by the amount of accounts payable at the Closing that is in excess of \$100,000 and increased by the exact amount (if any) that the total accounts payable is less than \$100,000 provided, however, that the final installments totaling [***] for the Loquendo license (No. LDE-072909MBMeridian) have been paid prior to the Closing; (iv) reduced by the amount that the liability for earned but unpaid Sick Leave and Vacation exceeds [***] at the Closing; (v) reduced by an amount equal to 15% of the amount that Backlog at the Closing is less than [***]; (vi) reduced by the Employee 2010 Bonus Holdback; (vii) reduced by the GDOT 511 Contract Holdback (as defined in Schedule 1.2(a)) ((i) through (vii) collectively, the “**Closing Cash Payment**”); and (viii) reduced by the GFJDA Closing Payment (the “**Net Closing Cash Payment**”);

(b) Nine Hundred Fifty Thousand Dollars (\$950,000) on the twelve (12) month anniversary of the Closing adjusted as follows: (i) reduced (if applicable) by the GDOT 511 12-Month Holdback (as defined in Schedule 1.2(b)); (ii) reduced by the MDSS First Year License Adjustment (as defined in Schedule 1.2(b)); (iii) reduced (if applicable) by the amount attributable to the termination of one or more employment of Key Employees as set forth in Schedule 1.2(b); and (iv) reduced by the GFJDA Contingent Payments, if any, attributable to the payment of consideration under this Section 1.2(b) (determined without taking into account the adjustment contemplated by this subsections (iv)) (collectively, the “**First Deferred Payment**”);

(c) One Million Dollars (\$1,000,000) on the twenty-four (24) month anniversary of the Closing adjusted as follows: (i) reduced (if applicable) by the GDOT 511 Shortfall Amount (as defined in Schedule 1.2(b)); (ii) reduced by the MDSS Second Year License Adjustment; (iii) reduced (if applicable) by the amount attributable to the termination of one or more employment of Key Employees as set forth in Schedule 1.2(c); and (iv) reduced by the GFJDA Contingent Payments, if any, attributable to the payment of consideration under this Section 1.2(c) (determined without taking into account the adjustments contemplated by this subsection (iv)) (collectively, the “**Second Deferred Payment**” and together with the First Deferred Payment, the “**Deferred Payments**”); and

(d) To the extent earned, by wire transfer of immediately available funds to an account to be designated by the Sellers, the amount and payments to be made in the manner as set forth in Schedule 1.2(d) attached hereto (the “**Additional Consideration**”) reduced by the GFJDA Contingent Payments, if any, attributable to the payment of the Additional Consideration (collectively, the “**Net Additional Consideration**”).

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

For purposes of this Agreement, the term “**Company Indebtedness**” means, with respect to the Company at any date, without duplication: (i) all obligations for borrowed money or for the deferred purchase price of property or services (other than current liabilities accrued as accounts payable on the Closing Balance Sheet), whether or not evidenced by a writing; (ii) all obligations evidenced by bonds, debentures, notes or other similar instruments (including, without limitation, any seller notes, deferred purchase price obligations or earn-out obligations issued or entered into in connection with any acquisition undertaken by the Company); (iii) all obligations in respect of letters of credit, to the extent drawn, and bankers’ acceptances issued for the account of the Company; (iv) all of indebtedness of any other Person and obligations of any other Person secured by a Lien on the property of the Company; (v) all obligations with respect to capital leases; and (vi) any accrued interest, prepayment premiums or penalties related to any of the foregoing; “**Person**” means an individual, a corporation, a partnership, a limited liability company, an association, a trust or other entity or organization, including a government or political subdivision or an agency or instrumentality thereof; and “**Lien**” means, with respect to any asset, any lien, pledge, charge, security interest or other encumbrance of any kind.

Subject to the terms of this Agreement, the Deferred Payments, if any, and Net Additional Consideration, if any, shall be paid at the times specified herein by Buyer to the Shareholders Representative (for further distribution to the Sellers, as set forth in Schedule A (the “**Allocation Schedule**”)), by wire transfer of immediately available funds to the account designated by Shareholders Representative prior to Closing. Buyer shall deliver to the Sellers (i) the First Deferred Payment, if any, within thirty (30) days after the first anniversary of the Closing and (ii) the Second Deferral Payment, if any, within thirty (30) days after the second anniversary of the Closing.

1.3 Adjustments to Purchase Price

(a) Adjustment at Closing. On or before the second Business Day prior to the Closing Date, the Company shall deliver to Buyer an estimated balance sheet of the Company, which fairly estimates and presents the financial position of the Company as at the close of business on the Closing Date (the “**Closing Balance Sheet**”), as well as a calculation of the following based on the estimated Closing Balance Sheet: (i) the sum of cash and accounts receivable at the Closing (the “**Estimated Current Assets**”), (ii) the amount of accounts payable at the Closing (the “**Estimated A/P**”) and (iii) the amount of Backlog at the Closing (the “**Estimated Backlog**”), certified by the chief financial officer of the Company. The Company and Buyer shall use the Buyer’s calculation of Estimated Current Assets, Estimated A/P and Estimated Backlog for purposes of calculating the Aggregate Purchase Price pursuant to Section 1.2 and Schedule 1.2(a)(i), (ii) and (iii); provided, however, that the Closing Balance sheet shall not include, and the calculations of Current Assets and A/P for purposes of this Section 1.3(a) and Section 1.3(b) shall not include, any estimated taxes payable or refundable or deferred tax liabilities or assets for the pre-Closing Tax periods.

(b) Adjustment After Closing. After the Closing, the Aggregate Purchase Price shall be (i) reduced by the amount, if any, by which (1) the Estimated Current Assets exceeds the final sum of cash and accounts receivable at the Closing (the “**Final Current Assets**”), (2) the final amount of accounts payable at the Closing (the “**Final A/P**”) exceeds the Estimated A/P, and (3) the Estimated Backlog exceeds the final amount of Backlog at the Closing (the “**Final Backlog**”), but only if the Final Backlog is less than [***] and only to the extent of the lesser of (A) the difference between [***] and the amount of the Final Backlog, and (B) the difference between the Estimated Backlog and the Final Backlog, as determined pursuant to Section 1.4, or (ii) increased by the amount, if any, by which (1) the Final Current Assets exceeds the Estimated Current Assets, (2) the Estimated A/P exceeds the Final A/P, and (3) the Final Backlog exceeds the Estimated Backlog, but only if the Estimated Backlog was less than [***] and only to the extent of the lesser of (A) the difference between [***] and the Estimated Backlog and (B) the difference between the Estimated Backlog and the

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

Final Backlog. (The reduction in and addition to the Aggregate Purchase Price referred to in the preceding sentence are hereafter collectively referred to as the “**Post-Closing Reduction**” and “**Post-Closing Addition**”, respectively). After the Closing Balance Sheet and the calculation of the Final Current Assets, Final Current A/P and Final Backlog become final and binding upon the parties in accordance with the provisions of Section 1.4, then, within ten (10) days following such calculation: (i) if any Post-Closing Reduction is required, the Shareholders Representative shall deliver such Post-Closing Reduction to Buyer in immediately available funds by wire transfer or check to Buyer; and (ii) if any Post-Closing Addition is required, Buyer shall immediately deliver such Post-Closing Addition in immediately available funds by wire transfer or check to Shareholders Representative (for further distribution to the Sellers Allocation Schedule).

1.4 Closing Balance Sheet.

(a) As soon as practicable after the Closing Date, but no later than the sixtieth (60th) day after the Closing Date, the Shareholders Representative will deliver to Buyer the final Closing Balance Sheet and the calculation of (i) the Final Current Assets, (ii) the Final A/P and (iii) the Final Backlog, based upon the final Closing Balance Sheet. The Closing Balance Sheet shall be prepared in accordance with U.S. generally accepted accounting principles (“**GAAP**”) consistently applied except that it shall exclude estimated taxes payable or refundable for the pre-Closing Tax periods, and deferred tax liabilities or assets. If Buyer objects to the Shareholders Representative’s calculations of the Final Current Assets, the Final A/P and/or the Final Backlog, Buyer shall within fifteen (15) days after receipt thereof notify the Shareholders Representative of the same in writing, which such notice shall include the basis of such objection in reasonable detail and Buyer’s proposed modification of such calculations to the Shareholders Representative. If Buyer does not object to such calculation within such fifteen (15) day period, the Shareholders Representative’s calculation shall be final, conclusive and binding on the parties.

(b) If the Shareholders Representative disagrees with all or any portion of Buyer’s proposed modifications of the Final Current Assets, Final A/P and/or Final Backlog delivered by Buyer pursuant to Section 1.4(a), the parties shall negotiate in good faith to reach an agreement during the fifteen (15) day period following delivery of such proposed modification by Buyer.

(c) If, upon completion of such fifteen (15) day period, Buyer and the Shareholders Representative are unable to reach an agreement, they shall promptly thereafter cause BDO Seidman, 3200 Bristol St., 4th Floor, Costa Mesa, CA 92626 (or other accounting firm mutually agreed to by the Shareholders Representative and Buyer) (the “Independent Accountant”) to review this Agreement and the disputed items or amounts for the purpose of calculating the Final Current Assets, the Final A/P and the Final Backlog. In making such calculation, the Independent Accountant shall consider only those items or amounts in the Closing Balance Sheet or the calculations of the Final Current Assets, the Final A/P and the Final Backlog as to which Buyer and the Shareholders Representative have disagreed. The Independent Accountant shall deliver to the Shareholders Representative and Buyer, as promptly as practicable, a report setting forth its calculations. Such report shall be final and binding upon Buyer and Sellers. The cost of such review and report shall be paid (i) one-half by Sellers, pro rata in accordance with the Shares owned by each Seller as set forth on the Shareholder List (defined in Section 2.6) (“**Pro Rata**”), and (ii) one-half by Buyer.

(d) The parties hereto agree that they will cooperate and assist in the preparation of the Closing Balance Sheet and in the conduct of the reviews and calculations referred to in Sections 1.3 and 1.4, including, without limitation, making available, to the extent necessary, books, records, work papers and personnel.

2. REPRESENTATIONS AND WARRANTIES OF THE COMPANY.

Subject to such exceptions as are disclosed in the disclosure schedules supplied by Company to Buyer (the “**Disclosure Schedule**”), the Company hereby represents and warrants to Buyer, as of the date of this Agreement and again at and as of the Closing, as follows:

2.1 Organization, Good Standing and Qualification. The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of North Dakota, with full legal power and authority to execute and deliver this Agreement and to consummate the transactions contemplated hereby, and to own its assets and conduct its businesses as owned and conducted. The Company is duly qualified to do business as a foreign corporation and is in good standing in each jurisdiction where the character of the property owned or leased by it or the nature of its activities make such qualification necessary. The Company has heretofore delivered to Buyer true and complete copies of its Articles of Organization and Bylaws.

2.2 Authorization of Agreement. The execution, delivery and performance of this Agreement by Company and the consummation of the transactions contemplated hereby have been duly and validly authorized by all necessary action on the part of the Company and Sellers. No further authorization is required on the part of the Company or Sellers to consummate the transactions contemplated hereby.

2.3 Valid and Binding Agreements. This Agreement constitutes the legal, valid and binding obligations of the Company, enforceable against the Company in accordance with its terms, except to the extent limited by laws of general application relating to bankruptcy, insolvency, reorganization and other laws affecting creditors’ rights generally.

2.4 No Breach of Statute or Contract. Neither the execution, delivery and performance of this Agreement by Company, nor compliance with the terms and provisions of this Agreement on the part of Company, will: (a) to the Company’s Knowledge, violate any statute or regulation of any governmental authority, domestic or foreign, affecting the Company or Sellers, (b) to the Company’s Knowledge, require the issuance of any authorization, license, consent or approval of any federal or state governmental agency; (c) contravene or conflict with or constitute a violation of any provision of applicable law, any of the terms, conditions or provisions of the organizational documents of Company or any judgment, order, injunction, or decree binding upon or applicable to the Company; (d) except as set forth on Schedule 2.4(d) of the Disclosure Schedule, constitute a default under or give rise to any right of termination, cancellation or acceleration of any obligation of the Company or to a loss of any material benefit to which the Company is entitled under any provision of any agreement, contract or other document or any material license, permit or other similar authorization held by the Company, or (e) result in the creation of a Lien on any asset of the Company. For purposes of this Agreement, “**Company’s Knowledge**” means the knowledge of the directors and officers of the Company and other individuals that have a similar position or have similar powers and duties as the officers and directors of the Company, including, in the case of such officers, the knowledge of facts that such officers should have after due inquiry.

2.5 Ownership of the Business. Except as set out in Schedule 2.5 of the Disclosure Schedule no portion of the Business is owned or operated by any Person other than Company, and none of the assets or properties utilized in the Business is owned by any person or entity other than Company.

2.6 Capitalization; Title to Shares; Shareholders List.

(a) The authorized capital stock of the Company consists of five hundred thousand shares of authorized Common Stock and twenty thousand shares of authorized Preferred Stock, of which 266,900 shares of Common Stock are issued and outstanding and zero (0) shares of Preferred Stock are issued and outstanding, and there are no other options for, rights to acquire, agreements to issue, or securities exercisable for or convertible into shares of the Company's capital stock.

(b) Schedule 2.6 of the Disclosure Schedule is a true, complete and accurate list (the "**Shareholders List**") that sets forth the name of each holder of the Shares as of the date hereof, exactly as such holder's name is set forth on the share certificate(s). The Shareholders List also sets forth with respect to each such holder the share certificate numbers held by such holder and the number of Shares evidenced by each such share certificate.

2.7 Subsidiaries and Other Equity Investments. The Company does not own any shares of capital stock of any corporation or any equity investment in any other Person.

2.8 Financial Information.

(a) Schedule 2.8(a) of the Disclosure Schedule is the balance sheet and statement of operations of the Business of Seller as of November 30, 2010, as prepared by management of Seller (the "**Business Financial Statements**").

(b) Except for excluding estimated taxes payable or refundable for the pre-Closing Tax period as well as deferred tax liabilities or assets, the Business Financial Statements were prepared in accordance with GAAP and fairly present the financial position and results of operations of the Company as of the dates thereof and for the periods reflected therein, subject in the case of interim financial statements, to normal recurring year-end adjustments and the absence of notes.

(c) Except for liabilities reflected or reserved in the Business Financial Statements and/or in Schedule 2.8(c) of the Disclosure Schedule, liabilities incurred in the ordinary course of business since the date of the Business Financial Statements, the tax liability for the pre-Closing periods and deferred tax liabilities, there are no liabilities or obligations, whether absolute, accrued, contingent or otherwise of a type that would be required under GAAP to be disclosed on a balance sheet or in the footnotes thereunder (none of which are material to the Business).

(d) Schedule 2.8(d) of the Disclosure Schedule contains: (i) a list reflecting the nature and amount of all obligations owed by the Company on the date hereof to any Seller, any Affiliate of a Seller; (ii) a list of all obligations of the Company guaranteed by a Seller and/or any of its Affiliates on the date hereof, and the terms of such guarantee; (iii) a list reflecting the nature and amount of all obligations owed to the Company on the date hereof by a Seller and/or any of its Affiliates; and (iv) a list setting forth the Company Indebtedness. Wherever used in this Agreement, the term "**Affiliate**" means, as respects any person or entity, any other person or entity that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the first person or entity.

2.9 No Material Changes. Except as and to the extent described in Schedule 2.9 of the Disclosure Schedule (which Schedule may make reference to any other Schedule hereto) and/or in the Business Financial Statements, since November 30, 2010, the Company has been operated only in the ordinary course consistent with past practices, and there has not been:

- (a) any material change in the financial condition, operations or business of the Company, any acquisition or disposition of assets, or any other material transaction or commitment relating to the Company;
- (b) any damage, destruction or loss, whether covered by insurance or not, materially and adversely affecting the operations, assets, properties, financial condition or prospects of the Company;
- (c) any declaration, payment or setting aside of any dividend or other distribution (other than in cash) of any assets or property utilized by the Company;
- (d) any material increase in the rate of salary or compensation paid or payable to any employee, consultant or other person performing services to the Company; or
- (e) any other event or condition arising from or out of the operations of the Company (for the avoidance of doubt, not including general economic and market conditions and laws and governmental actions of general application that do not disproportionately affect the Company) which has or could reasonably be expected to be likely to materially and adversely affect the business, financial condition, results of operations or prospects of the Company.

2.10 Tax Returns and Tax or Other Audits.

(a) Except as and to the extent disclosed in Schedule 2.10(a) of the Disclosure Schedule: (i) all federal, state and local tax returns and tax reports required to be filed by Company on or before the date of this Agreement have been timely filed with the appropriate governmental agencies in all jurisdictions in which such returns and reports are required to be filed in accordance with all applicable laws, and such returns are true, correct and complete in all material respects; (ii) all federal, state and local income, franchise, sales, use, property, excise, unemployment, payroll withholding, alternative or add-on minimum tax, governmental fee or other like assessment or charge, together with any interest or any penalty, addition to tax or additional amount (“**Tax**”) imposed by any governmental authority responsible for the imposition of any such tax (domestic or foreign) (a “**Taxing Authority**”) and other Taxes (including interest and penalties and including estimated tax installments where required to be filed and paid) due from or with respect to Company as of the date of this Agreement have been fully paid; (iii) all Taxes and other assessments and levies that Company is required by law to withhold or to collect have been duly withheld and collected, and have been paid over to the proper governmental authorities to the extent due and payable on or before the date of this Agreement; (iv) there are no outstanding or pending claims, deficiencies or assessments for Taxes, interest or penalties with respect to any taxable period of Company; v) for 2010 Tax calendar year, Company has prepaid taxes in the amounts of \$20,000.00 to the federal government, \$520.00 to the state of Georgia, \$500.00 to the state of Minnesota and \$5,000.00 to the state of North Dakota; (vi) the charges and accruals for Taxes with respect to the Company for any pre-Closing Tax period reflected on the books of the Company are adequate to cover such Taxes; (vii) the Company is not liable with respect to Taxes of any other Person nor is a party to any agreement providing for payment with respect to Taxable income; (viii) no Taxing Authority has asserted an adjustment that would reasonable be likely to result in an additional Tax for which the Company is or may be liable or that would reasonably be

expected to result in a Lien on any assets of the Company (collectively “**Tax Liability**”); (ix) there is no pending audit, examination, investigation, dispute, proceeding or claim (collectively, “**Proceeding**”) relating to any Tax Liability and the Company’s Knowledge, no Taxing Authority is contemplating such a Proceeding; (x) there is no outstanding power of attorney authorizing anyone to act on behalf of the Company in connection with a Tax Liability, Tax return or Proceeding relating to a Tax, and there is no outstanding closing agreement, ruling request, request to change a method of accounting, subpoena or request for information with or by any Taxing Authority with respect to the Company; and (xi) the Company is not nor has it ever been included in any consolidated, combined or unitary Return.

(b) Except as set forth in Schedule 2.10(b) of the Disclosure Schedule, there are no audits pending with respect to any federal, state or local tax returns of Company, and no waivers of statutes of limitations have been given or requested with respect to any tax years or tax filings of Company.

(c) Except as set forth in Schedule 2.10(c) of the Disclosure Schedule, there are no federal, state or local audits pending with respect to any contracts to which the Company is a party that relate to the Business.

2.11 Personal Property; Liens.

(a) Company has good and indefeasible title to, or in the case of leased property has valid leasehold interests in, all of its property and assets (whether real or personal, tangible or intangible) reflected on the Business Financial Statements or acquired after the date of the Business Financial Statements. Except as set forth on Schedule 2.11, none of such property or assets is subject to any Liens, except for the following: (i) liens for current taxes of Company that are not yet due and payable or that are being contested in good faith by appropriate proceedings and for which proper reserves have been established by Company; (ii) mechanics’, carriers’, workers’, repairers’ and similar statutory Liens arising or incurred in the ordinary course of business for amount that are not delinquent and that are not material, either individually or in the aggregate (collectively, “**Permitted Liens**”).

(b) Schedule 2.11(b) sets forth, as of the date hereof, a description of each item of tangible personal property leased by the Company. Such properties of the Company that are used in its business are in reasonable operating condition and repair, subject only to the ordinary wear and tear of the business.

2.12 Real Property.

(a) Company does not currently own and has never owned any real property. Schedule 2.12(a) lists all real estate leased by the Company.

(b) Company (and, to the Company’s Knowledge, the landlords thereunder) is presently in compliance in all material respects with all of its obligations under the real property leases set forth on Schedule 2.12(a).

2.13 Contracts and Commitments.

(a) All contracts, leases, commitments, indentures and other agreements relating to the Business to which Company is a party, including without limitation all contracts, subcontracts, purchase orders, agreements, subagreements, or other agreements with customers or clients of the Business to provide products and/or services, (collectively, “**Material Contracts**”) are listed

in Schedule 2.13(a) Schedule 2.13(a) need not list any of the following : (i) agreements for the purchase of supplies or other inventory items in the ordinary course of the Business involving aggregate payments of less than Five Thousand Dollars (\$5,000); or (ii) agreements related to the purchase or lease of any capital asset involving aggregate payments of less than Five Thousand Dollars (\$5,000) per annum by Company.

(b) Except as set forth in Schedule 2.13(b): (i) the Material Contracts are in full force and effect; and (ii) the Company is in compliance in all material respects with all of its obligations under the Material Contracts, and has not received any written notice that any party to any Material Contract is in material breach or default of such Material Contract or is now subject to any condition or event that has occurred and that, after notice or lapse of time or both, would constitute a material default by any party under any such contract, lease, agreement or commitment.

(c) Except as set forth in Schedule 2.13(c), the Company does not have any outstanding contracts with or commitments to officers, employees, technicians, agents, consultants or advisors that are not cancelable by Company without penalty, premium or liability (for severance or otherwise) on less than thirty (30) days' prior written notice.

2.14 Labor, Benefit and Employment Agreements.

(a) Schedule 2.14(a) lists, as of the date of this Agreement, all stock option plans, employment, consulting and severance agreements, pension, profit sharing and retirement plans and all bonus and other employee benefit plans, including, without limitation, "employee benefit plans" as such term is 3(3) of ERISA, maintained or with respect to which contributions are made by the Company or with respect to which the Company has any liability (the "**Company Plans**").

(b) Schedule 2.14(b) sets forth the amount of all compensation or remuneration (including any discretionary bonuses) paid by Company during the 2010 calendar year, to employees or consultants of the Company who then received or presently receive aggregate compensation or remuneration at an annual rate in excess of Twenty-Five Thousand Dollars (\$25,000).

(c) Except as set forth in Schedule 2.14(c) of the Disclosure Schedule, Company is not a party to and has no commitment or obligation in respect of (i) any collective bargaining agreement or other labor agreement, or (ii) any agreement with respect to the employment or compensation of any non hourly and/or non union employee(s) of the Company. No union is now certified or, to the best of Company's Knowledge, claims to be certified as a collective bargaining agent to represent any employees of the Company, and there are no labor disputes existing or, to the best of Company's Knowledge, threatened, involving strikes, slowdowns, work stoppages, job actions or lockouts of any employees of the Company.

(d) The Company is not the subject of any proceeding asserting that the Company has committed an unfair labor practice or that is seeking to compel the Company to bargain with any labor union or other labor organization, and there is not pending or, to the Company's Knowledge, threatened, any labor strike, dispute, walkout, work stoppage, slow-down or lockout involving the Company. Neither the Company nor any Seller has received any written notice of any actual or alleged violation by the Company of any law, regulation, order or contract term affecting the collective bargaining rights of employees, equal opportunity in employment, or employee health, safety, welfare, or wages and hours.

(e) With respect to any “multiemployer plan” (as defined in Section 3(37) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”)) to which Company or any of its Affiliates has at any time been required to make contributions, neither the Company nor any of its Affiliates has, at any time on or after April 29, 1980, suffered or caused any “complete withdrawal” or “partial withdrawal” (as such terms are respectively defined in Sections 4203 and 4205 of ERISA) therefrom on its part.

(f) Except as disclosed in Schedule 2.14(f), the Company does not maintain, or have any liabilities or obligations of any kind with respect to, any bonus, deferred compensation, pension, profit sharing, retirement or other such benefit plan, or any potential or contingent liability in respect of any actions or transactions relating to any such plan other than to make contributions thereto if, as and when due in respect of periods subsequent to the date hereof. Without limitation of the foregoing, (i) the Company has made all required contributions to or in respect of any and all such benefit plans, (ii) no “accumulated funding deficiency” (as defined in Section 412 of the Internal Revenue Code of 1986, as amended (the “Code”)) has been incurred in respect of any of such benefit plans, and the present value of all vested accrued benefits thereunder does not, on the date hereof, exceed the assets of any such plan allocable to the vested accrued benefits thereunder, (iii) to the Company’s Knowledge there has been no “prohibited transaction” (as defined in Section 4975 of the Code) with respect to any such plan, and no transaction which could give rise to any tax or penalty under Section 4975 of the Code or Section 502 of ERISA, and (iv) to the Company’s Knowledge there has been no “reportable event” (within the meaning of Section 4043(b) of ERISA) with respect to any such plan. All of such plans which constitute, are intended to constitute, or have been treated by Company as “employee pension benefit plans” or other plans within Section 3 of ERISA have been determined by the Internal Revenue Service to be “qualified” under Section 401(a) of the Code, and to the Company’s Knowledge have been administered and are in compliance with ERISA and the Code; and to the Company’s Knowledge, there are no facts, conditions or occurrences such as would impair the “qualified” status of any of such plans.

(g) Except for the group insurance programs listed in Schedule 2.14(a), Company does not maintain any medical, health, life or other employee benefit insurance programs or any welfare plans (within the meaning of Section 3(1) of ERISA) for the benefit of any current or former employees, and, except as required by statutory law, Company does not have any liability, fixed or contingent, for health or medical benefits to any former employee.

(h) The Company is in compliance with all applicable federal, state and local laws, rules and regulations (domestic and foreign) respecting employment, employment practices, terms and conditions of employment and wages and hours. Each employee of the Company is in compliance with all applicable visa and work permit requirements.

2.15 Compliance with Laws; No Defaults.

(a) To the Company’s Knowledge, Company is in compliance in all material respects with all laws, statutes, regulations, rules and ordinances applicable to the Company; and the Company has not received any written notice of any default or violation under or in respect of any of the foregoing.

(b) Except as set forth in Schedule 2.4 and Schedule 2.15(b) to the Disclosure Schedule, the Company is not in default under, and, to the Company’s Knowledge, no condition exists that with notice or lapse of time or both would constitute a default under, (i) any Material Contract, or (ii) any judgment, order or injunction of any court, arbitrator or governmental body, agency or authority.

(c) Neither the Company nor, to the Company's Knowledge, any of Company's managers, officers or employees, has received any written notice of default or violation, nor is Company or, to the Company's Knowledge, any of its managers, officers or employees in default or violation, with respect to any judgment, order, writ, injunction, decree, demand or assessment issued by any court or any federal, state, local, municipal or other governmental agency, board, commission, bureau, instrumentality or department, domestic or foreign, relating to any aspect of the Business. Except as set forth on Schedule 2.15(c) to the Disclosure Schedule, neither Company nor, to the Company's Knowledge, any of Company's managers, officers or employees, received written notice of, been charged with, or is under investigation with respect to, any violation of any provision of any federal, state, local, municipal or other law or administrative rule or regulation, domestic or foreign, relating to any aspect of the Business.

2.16 Environmental Matters.

(a) Without limitation of Section 2.15(a) above, the Company has not, at any time (i) handled, stored, generated, processed, released or disposed of any hazardous substances in violation of any Environmental Law, or (ii) otherwise committed any material violation of any Environmental Law (including, without limitation, the provisions of the Environmental Protection Act, the Comprehensive Environmental Responsibility and Cleanup Act, and other applicable environmental statutes and regulations) or any material violation of the Occupational Safety and Health Act. For purposes of this Agreement, "**Environmental Law**" means any and all federal, state, local and foreign statutes, laws, judicial decisions, regulations, ordinances, rules, judgments, orders, decrees, codes, plans, injunctions, permits, concessions, grants, franchises, licenses, agreements and governmental restrictions, relating to human health, the environment or to emissions, discharges or releases of pollutants, contaminants or other hazardous material or wastes into the environment, including without limitation ambient air, surface water, ground water or land, or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport or handling of pollutants, contaminants or other hazardous material or wastes or the clean-up or other remediation thereof.

(b) No audits or inspections of the Company have been conducted by or on behalf of the Environmental Protection Agency, the Occupational Safety and Health Administration, any corresponding or comparable state or local governmental department, agency or authority, or any other governmental and/or quasi governmental agency (federal, state and/or local). There is no lawsuit or proceeding relating to any Environmental Law pending or, to the Company's Knowledge, threatened against the Company.

(c) The Company and its properties are in compliance with all Environmental Laws. There are no facts or circumstances that would be reasonably expected to form the basis for any claims against the Company under any Environmental Law.

2.17 Litigation. Except as disclosed in Schedule 2.17 of the Disclosure Schedule, there is no suit, action, arbitration, or legal, administrative or other proceeding or governmental investigation (including, without limitation, any claim alleging the invalidity, infringement or interference of any patent, patent application, or rights thereunder owned or licensed by Company) pending, or to the Company's Knowledge, threatened, by or against Company or any of its properties before any court or arbitrator or any governmental body, agency, official or authority. No event has occurred, and no claim, dispute or other condition or circumstance exists, that will, or that could reasonably be expected to, give rise to or serve as a basis for the commencement of any suit, action, arbitration, proceeding or investigation against or with respect to Company

2.18 **Intellectual Property.** Schedule 2.18 of the Disclosure Schedule sets forth a list and brief description of the nature and ownership of and interest of any nature of: (a) each item of Registered IP and unregistered Trademarks in which Company has or purports to have an ownership interest of any nature; (b) each contract or license pursuant to which any Intellectual Property Right is or has been licensed, sold, assigned or otherwise conveyed or provided to Company; (c) each contract pursuant to which any person has been granted any license under or interest in any Company IP; and (d) excluding items listed under (a) through (c), a complete list without extensive or revealing descriptions of Tech Knowledge sufficient to identify such Tech Knowledge and the location of its documentation. The Company IP does not infringe upon or misappropriate any Intellectual Property rights of any Person. Company owns all right, title and interest to and in the Company IP Rights, free and clear of any liens, encumbrances, restrictions or legal or equitable claims of others. Company has taken all reasonable security measures to protect the secrecy, confidentiality, and value of the Company IP. Any of Company's employees, contractors, or consultants, and any other persons who, either alone or in concert with others, developed, invented, discovered, derived, programmed, or designed the Company IP, or who have knowledge of or access to information relating to Company IP, have entered into confidentiality, invention assignment and proprietary information agreement with the Company, which agreement vest in the Company all ownership rights of any Intellectual Property created by such employees, independent contractors and consultants during the course of their employment or engagement, as applicable. All Company IP is valid and enforceable and is not part of the public knowledge or literature, nor to Company's Knowledge has it been used, divulged, or appropriated for the benefit of any past or present employees or other persons, or to the detriment of Company. None of the proprietary software of the Company or any software licensed to the Company to which the Company has made modifications, including customizations, or any portion thereof, contains, is based on or derived from, was developed using or with reference to, or is distributed linked (statically or dynamically) with any Open Source Software. The Company owns and possess free and clear of all Liens all right, title, and interest in and to, or has the right to use pursuant to a valid and enforceable license, the Intellectual Property necessary for the operation of its business as currently operating. The Company has not infringed, misappropriated or diluted or otherwise come into conflict with any Intellectual Property rights of any third parties.

As used in this Section 2.18:

"Company IP" shall mean all Intellectual Property and Intellectual Property Rights in which Company has an ownership interest or an exclusive license or similar exclusive right.

"Intellectual Property" shall mean sales methodologies and processes, training protocols and similar methods and processes, algorithms, apparatus, circuit designs and assemblies, gate arrays, net lists, test vectors, databases, data collections, diagrams, formulae, inventions (whether or not patentable), know-how, logos, marks (including brand names, product names, logos, and slogans), methods, network configurations and architectures, processes, proprietary information, protocols, schematics, specifications, software, software code (in any form, including source code and executable or object code), subroutines, techniques, user interfaces, URLs, web sites, works of authorship and other forms of technology (whether or not embodied in any tangible form and including all tangible embodiments of the foregoing, such as instruction manuals, laboratory notebooks, prototypes, samples, studies and summaries).

“Intellectual Property Rights” shall mean all rights of the following types, which may exist or be created under the laws of any jurisdiction in the world: (a) rights associated with works of authorship, including exclusive exploitation rights, copyrights and moral rights; (b) trademark and trade name rights and similar rights; (c) trade secret rights; (d) patent and industrial property rights; (e) other proprietary rights in Intellectual Property; and (f) rights in or relating to registrations, renewals, extensions, combinations, divisions, and reissues of, and applications for, any of the rights referred to in clauses “(a)” through “(e)” above.

“Open Source Software” shall mean any software, or any portion thereof, in source code or object code, that is licensed, distributed or made available under any license or other distribution agreement (a) containing any of the following terms and conditions: (i) licensees of such software must have the right to copy, sell or give away such software or modifications or derivative works thereof without compensation to the licensor, (ii) licensees of such software must receive or have available access to the source code for such software, (iii) licensees of such software must have the right to modify and create derivative works of such software or (b) that is certified by the Open Source Initiative or otherwise compliant with the most current version of the Open Source Definition as published by the Open Source Initiative. Open Source Software, without limitation, includes software licensed or distributed under any of the following licenses or licenses similar to any of the following: (1) GNU’s General Public License (GPL) or Lesser/Library GPL (LGPL), (2) the Artistic License (e.g. PERL), (3) the Mozilla Public License, (iv) the Netscape Public License, (4) the Berkeley software design (BSD) license including Free BSD or BSD-style license, (5) the Sun Community Source License (SCSL), (6) an Open Source Foundation License (e.g. CDE and Motif UNIX user interfaces), and (7) the Apache Server license.

“Registered IP” shall mean all Intellectual Property Rights that are registered, filed or issued under the authority of, with or by any governmental body, including all patents, registered copyrights, registered trademarks and all applications for any of the foregoing.

“Tech Knowledge” shall mean technical knowledge consisting of the processes, know-how, documentation, ideas, concepts, methodology, internally developed and licensed software, and algorithms for the development, distribution, and management of atmospheric and Earth sciences information and technology, the development, implementation and operation of MDSS, of the development, implementation, and operation of ATIS including traveler information and 511 systems and their related internet and telephony distribution systems.

2.19 Customers and Sales. Schedule 2.19 of the Disclosure Schedule sets forth a list of all customers of the Company together with summaries of the sales made to each customer during the most recent fiscal year. Except as indicated in Schedule 2.19, the Company has no information, nor is it aware of any facts, indicating that any of these customers have disagreements or disputes with the Company (including, without limitation disputed costs or invoices), intend to cease doing business with Company, or materially alter the amount of the business that they are presently doing with the Company.

2.20 Insurance Policies. Schedule 2.20 of the Disclosure Schedule to this Agreement is a description of all insurance policies held by Company, specifying as to each policy (i) the carrier, (ii) policy number, (iii) coverage limits and deductibles, and (iv) expiration date. Such policies are in full force and effect, all premiums thereon have been paid, and the Company is otherwise in compliance in all material respects with the terms and provisions of such policies. Company has maintained and now maintains (i) insurance on all its assets and business of a type customarily insured, covering property damage and loss of income by fire or other casualty, and (ii) adequate insurance protection against all

liabilities, claims, and risks against which it is customary to insure. Within the last two (2) years, the Company has not received any notice of cancellation or non-renewal of any such policy or arrangement or any material increase of premiums (that actually resulted in such cancellation, non-renewal or material increase) with respect to, any such insurance policies nor has the termination of any such policies or arrangements been threatened. Schedule 2.20 also sets forth a list of all pending claims and the claims history for the Company during the past two (2) years. Within the last two (2) years, the Company has not received (a) any refusal of coverage or any written notice that a defense will be afforded with reservation of rights, or (b) any written notice that the issuer of any policy is not willing or able to perform its obligations thereunder.

2.21 Interest in Customers, Suppliers and Competitors. Except as set forth in Schedule 2.21 of the Disclosure Schedule, no Seller, Affiliate of any Seller, officer, director, or employee of the Company, nor any spouse or child of any of them has any direct or indirect interest in any competitor, potential competitor, supplier, or customer of the Company or in any person from whom or to whom Company is doing business.

2.22 Transactions with Affiliates. Except as set forth on Schedule 2.22 to the Disclosure Schedule, there are no contracts, liabilities or obligations between the Company, on the one hand, and any Seller (or Affiliate of a Seller) on the other hand.

2.23 Going Concern. Neither Company nor Sellers has any knowledge of any fact, event, circumstance or condition (including, without limitation, any announced changes in the policies of any material client or customer) that would, absent the transactions contemplated by this Agreement, materially impair the ability of Buyer, from and after the Closing (as such term is hereinafter defined), to continue the Business in substantially the manner heretofore conducted, other than general, industry-wide conditions.

2.24 Disclosure and Duty of Inquiry. Buyer is not nor will it be required to undertake any independent investigation to determine the truth, accuracy and completeness of the representations and warranties made by Company and Sellers in this Agreement.

2.25 Accounts Receivable and Backlog. All of the Accounts Receivable as reflected in the Closing Balance Sheet are and as of the Closing will be, Accounts Receivable that arose in the ordinary course of business and are not subject to any valid counterclaims or setoffs (other than as set forth in the Closing Balance Sheet). At the Closing Company will have a backlog of firm verifiable non-terminable orders for products and services of no less than [***] (the "**Backlog**").

2.26 Other Tangible Personal Property. No personal property, including, but not limited to, machinery, equipment, furniture, supplies, tools, dies, jigs, molds, patterns, drawings, and all other tangible personal property owned by, in the possession of, or used by Company in connection with the Business, is held under any lease, security agreement, conditional sales contract, or other title retention or security arrangement, or is located other than in the possession of Company.

2.27 Commercial Software. All commercial software installed or used on computers, servers, or other processing equipment owned or leased by the Company have valid licenses.

2.28 Bank Accounts; Powers of Attorney. Set forth in Schedule 2.28 to the Disclosure Schedule is an accurate and complete list showing (i) the name and address of each bank in which the Company has an account or safe deposit box, the number of any such account or any such box and the names of all Persons authorized to draw thereon or to have access thereto and (ii) the names of all Persons, if any, holding powers of attorney from the Company and a summary statement of the terms thereof.

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

2.29 Brokers' and Finders' Fees. There is no investment banker, broker or finder which has been retained by or is authorized to act on behalf of the Company who is entitled to any fee or commission from the Company or any Seller in connection with the transactions contemplated by this Agreement.

2.30 Disclosure. Neither this Agreement nor any of the schedules, attachments or exhibits hereto or agreements contemplated hereby contain any untrue statement by the Company or any Seller of a material fact or omit a material fact necessary to make each statement contained herein or therein, in light of the circumstances under which they were made, not misleading.

3. REPRESENTATIONS AND WARRANTIES OF SHAREHOLDERS.

Each of the following representations and warranties is made by each Seller as to himself, herself or itself only (and not with respect to any other Seller) as of the date of this Agreement and again at and as of the Closing:

3.1 Ownership. Such Seller has good and marketable title to the Shares set forth opposite such Seller's name on Schedule 2.6, and will convey to Buyer at the Closing good and marketable title to such Shares, free and clear of any Liens.

3.2 Authority. Such Seller has the requisite power and authority to execute and deliver this Agreement. This Agreement has been duly executed and delivered by such Seller and constitutes a valid and binding obligation of such Seller, enforceable against such Seller in accordance with its terms except to the extent limited by laws of general application relating to bankruptcy, insolvency, reorganization and other laws affecting creditors' rights generally.

3.3 Brokers' and Finders' Fees. There is no investment banker, broker or finder which has been retained by or is authorized to act on behalf of such Seller who is entitled to any fee or commission from the Company in connection with the transactions contemplated by this Agreement.

4. REPRESENTATIONS AND WARRANTIES OF BUYER.

In connection with the purchase of the Shares from Sellers hereunder, Buyer hereby represents and warrants to the Sellers as follows, which representations and warranties shall be deemed to be made as of the date of this Agreement and again at and as of the Closing:

4.1 Organization, Good Standing and Qualification. Buyer is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware, with all necessary power and authority to execute and deliver this Agreement, to perform its obligations hereunder, and to consummate the transactions contemplated hereby.

4.2 Authorization of Agreement. The execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby by Buyer have been duly and validly authorized by Buyer and Buyer has the full legal right, power and authority to execute and deliver this Agreement, to perform its obligations hereunder, and to consummate the transactions contemplated hereby. No further corporate authorization is necessary on the part of Buyer to consummate the transactions contemplated hereby.

4.3 Valid and Binding Agreement. This Agreement constitutes the legal, valid and binding obligations of Buyer, enforceable against Buyer in accordance with its terms, except, in each case, to the extent limited by bankruptcy, insolvency, reorganization and other laws affecting creditors' rights generally.

4.4 No Breach of Statute or Contract. Neither the execution and delivery of this Agreement by Buyer nor compliance with the terms and provisions of this Agreement on the part of Buyer, will: (a) to the best of Buyer's knowledge violate any statute or regulation of any governmental authority, domestic or foreign, affecting Buyer; (b) to the best of Buyer's knowledge require the issuance to Buyer of any authorization, license, consent or approval of any federal or state governmental agency; or (c) conflict with or result in a breach of any of the terms, conditions or provisions of Buyer's articles of incorporation, bylaws, or other organizational documents or any judgment, order, injunction, decree, note, indenture, loan agreement or other agreement or instrument to which Buyer is a party, or by which Buyer is bound, or constitute a default thereunder.

4.5 Duty of Inquiry. Company and Sellers are not and will not be required to undertake any independent investigation to determine the truth, accuracy and completeness of the representations and warranties made by Buyer in this Agreement.

5. COVENANTS AND AGREEMENTS OF THE PARTIES.

5.1 Confidentiality.

(a) Notwithstanding anything to the contrary contained in this Agreement, and subject only to any disclosure requirements that may be imposed upon any party under applicable state or federal securities, antitrust, or other laws, it is expressly understood and agreed by the parties that, except with respect to matters or information that are publicly available other than by reason of a breach of this Section 5.1, (i) this Agreement, the Schedules hereto, and the conversations, negotiations and transactions relating hereto and/or contemplated hereby, and (ii) all financial information, business records and other non-public information concerning either party that the other party or its representatives has received, shall be maintained in the strictest confidence by the recipient and its representatives and shall not be disclosed to any person that is not associated or affiliated with the recipient and involved in the transactions contemplated hereby, without the prior written approval of the party that provided the information; *provided, however*, that the existence and terms of this Agreement and the other agreements contemplated hereby may be disclosed by Company to Company's directors, stockholders, employees, attorneys, accountants, advisors and representatives. The parties hereto shall use every reasonable effort to avoid disclosure of any of the foregoing or undue disruption of any of the business operations or personnel of the parties, and no party shall issue any press release or other public announcement regarding the transactions contemplated hereby without the prior approval of each other party (such approval not to be unreasonably withheld or delayed) unless compelled to do so upon advice of counsel and there is insufficient time to practicably obtain approval hereunder.

(b) At any time from and after the Closing, each Seller hereby agrees that such Seller will not divulge, transmit or otherwise disclose or cause to be divulged, transmitted or otherwise disclosed, any business contacts or customer, technology, know-how, trade secrets, marketing techniques, contracts or other confidential or proprietary information with respect to

the Company of whatever nature (provided, however, that for purposes hereof, information shall not be considered to be confidential or proprietary if (i) it is a matter of common knowledge or public record, (ii) it is generally known throughout the industry, or (iii) Seller can demonstrate that such information was already known to the recipient thereof, in each case other than by reason of any breach of any obligation under this Agreement or any other confidentiality or non-disclosure agreement to which such Seller is a party);

5.2 Non-Competition. From and after the Closing each Individual Seller hereby agrees that at any time from and after the Closing Date through and including the five (5) year anniversary of the Closing Date (the "Non-Competition Period"), such Individual Seller will not, and will cause each of such Individual Seller's Affiliates not to, for any reason whatsoever, directly or indirectly, either individually or as an owner, partner, officer, director, manager, employee, lender or otherwise, engage in any business that (i) derives or seeks to derive any revenues from the development, distribution, and management of atmospheric and Earth sciences information and technology for commercial purposes related to collection and delivery of weather information to travelers and use for information, management and control of surface transportation; from the development, implementation and operation of MDSS for roadways; from the development, implementation, and operation of ATIS including traveler information and 511 systems, and of the related research and consulting services; and (ii) is or shall be located or operating, or servicing customers within the states and provinces of the United States, Canada, and Mexico; provided, however, that nothing herein shall prohibit the aforementioned individuals from being employed by any governmental entity or any college, university, or similar academic institution for so long as such governmental entity or academic institution does not directly or indirectly participate in, or provide assistance to any Person that participates in, the activities described in subclauses (i) and (ii) above for profit. In the event that an Individual Seller's employment with the Company is terminated after the Closing by the Company other than pursuant to a Discharge for Cause (as defined in Schedule 1.2(b)(iii)) or by the Individual Seller pursuant to a Termination for Good Reason (as defined in Schedule 1.2(b)(iii)), the Non-Competition Period for such Seller shall terminate upon the earlier of (A) the five (5) year anniversary of the Closing Date, and (B) the three (3) year anniversary of such termination.

5.3 Operations. From the date of this Agreement until the Closing and except as otherwise expressly provided in this Agreement, or agreed to in writing by Buyer, Company agrees (i) to conduct its business in the ordinary course consistent with past practice and (ii) to use its commercially reasonable efforts to (A) preserve the assets of the Company, (B) keep available the services of the current officers and employees of the Company, and (C) preserve the current relationship of the Company with customers and suppliers with which the Company has business relationships.

5.4 Negative Covenants. From the date of this Agreement until the Closing and except as otherwise expressly provided in this Agreement or agreed to by Buyer in writing, Company agrees not to do any of the following:

- (a) adopt any change in its Articles of Organization or Bylaws;
- (b) merge or consolidate with any other Person or acquire a material amount of assets of any other person (except for acquisitions of raw materials in the ordinary course of business consistent with past practices);
- (c) amend or terminate any Assumed Contract, or enter into any Material Contract;

(d) sell, assign, transfer, distribute or otherwise transfer or dispose of any assets except for dispositions in the ordinary course of business;

(e) cancel, forgive, release, discharge or waive any right with respect to the Company's assets, or agree to do any of the foregoing, except for compromises of accounts receivable in the ordinary course of business consistent with past practice; or

(f) take any action relating to any liquidation or dissolution of Company.

5.5 Access to and Provision of Additional Information. From the date of this Agreement until the Closing, Company (i) shall provide to Buyer full and complete access to and the right to inspect the Assets and books and records of Company, (ii) shall furnish to Buyer all material information requested by Buyer concerning the Company, and (iii) shall furnish to Buyer such additional operating and other data and information regarding the Company as Buyer may from time to time reasonably request, without regard to where such information may be located.

5.6 Governmental Authority Approvals; Consents to Assignment. From the date of this Agreement until the Closing, each of Buyer and Company shall (i) promptly apply for and use its reasonable best efforts to obtain prior to the Closing all consents, approvals, authorizations and clearances of governmental authorities required of it to consummate the transactions contemplated hereby, (ii) provide such information and communications to governmental authorities as the other party may reasonably request, and (iii) assist and cooperate with other persons to obtain all consents, licenses, permits, approvals, authorizations and clearances of governmental authorities that the other party reasonably deems necessary or appropriate, and in connection therewith to prepare any document or other information reasonably required of it to consummate the transactions contemplated herein, provided, however, that, notwithstanding the foregoing, no party shall have any obligation under such provisions (a) to pay any cash amounts to governmental authorities other than filing fees, or (b) to agree to divest assets or limit the operations of its businesses.

5.7 Casualty. If, prior to the Closing, any of Company's assets are destroyed or damaged by fire, theft, vandalism or other cause or casualty, Buyer may (i) terminate this Agreement in its entirety without penalty unless Company either reasonably promptly repairs or replaces such Assets in which event Company shall retain all right, title and interest in and to any insurance proceeds payable on account of such destruction or damage, or (ii) consummate the transaction notwithstanding such destruction or damage, in which event Company shall transfer and assign to Buyer at the Closing the insurance proceeds (or the right to receive the insurance proceeds) of any applicable insurance policy plus Company shall pay to Buyer any deductibles or co-payments required under the applicable insurance policy.

5.8 Release of Encumbrances. Company shall cause all liens, security interests, pledges and other encumbrances on the Company's assets, other than Permitted Liens, to be released and discharged at or prior to the Closing.

5.9 Release of Claims. Effective as of the Closing Date, except with respect to a claim (a) arising out of this Agreement or (b) occurring after the Closing Date, each Seller hereby irrevocably waives, releases and discharges Buyer and the Company and their respective Affiliates from any and all liabilities of any kind or nature whatsoever, in each case whether absolute or contingent, liquidated or unliquidated, known or unknown, and such Seller shall not seek to recover any amounts in connection therewith or thereunder from any such Person. Without limiting the generality of the foregoing, each Seller waives all rights under California Civil Code Section 1542 (and other similar state statute), which provides:

A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTOR.

Each Seller also hereby waives the benefits of, and any rights such Seller may have under, any statute or common law principle of similar effect in any jurisdiction. Such released liabilities shall include, without limitation, any right to recover against Buyer or the Company for any indemnification claims made against or paid by any Seller pursuant to Section 9.

5.10 Notification; Updates to Disclosure Schedule. From the date of this Agreement until the Closing, the Company and Sellers shall promptly notify the Buyer in writing of: (a) the discovery by the Company or any Seller of any event, condition, fact or circumstance that occurred or existed on or prior to the date of this Agreement and that caused or constitutes a breach of any representation or warranty made by the Company or Seller in this Agreement; (b) any event, condition, fact or circumstance that occurs, arises or exists after the date of this Agreement and that would cause or constitute a breach of any representation or warranty made by the Company or Seller in this Agreement if (i) such representation or warranty had been made as of the time of the occurrence, existence or discovery of such event, condition, fact or circumstance, or (ii) such event, condition, fact or circumstance had occurred, arisen or existed on or prior to the date of this Agreement; (c) any breach of any covenant or obligation of the Company or Seller; and (d) any event, condition, fact or circumstance that may make the timely satisfaction of any of the conditions set forth in Section 6 impossible or unlikely. If any event, condition, fact or circumstance that is required to be disclosed pursuant to this Section 5.10 requires any change in the Disclosure Schedule, or if any such event, condition, fact or circumstance would require such a change assuming the Disclosure Schedule were dated as of the date of the occurrence, existence or discovery of such event, condition, fact or circumstance, then the Seller shall promptly deliver to the Buyer an update to the Disclosure Schedule specifying such change. No such update shall be deemed to supplement or amend the Disclosure Schedule for the purpose of (i) determining the accuracy of any representation or warranty made by the Company or Sellers in this Agreement or in the Closing Certificate, or (ii) determining whether any of the conditions set forth in Section 6 has been satisfied.

6. CONDITIONS PRECEDENT TO THE OBLIGATIONS OF BUYER.

The obligations of Buyer hereunder are subject to the satisfaction at or prior to the Closing of the following conditions, unless waived in writing by Buyer:

6.1 Representations and Warranties; Covenants. Each of the representations and warranties of Company and Sellers shall be true and correct on and as of the Closing. Each of the terms, covenants and agreements to be complied with or performed by Company on or before the Closing shall have been complied with and performed. Buyer will have received a certificate executed by the Chief Executive Officer of the Company confirming the above.

6.2 Consents. The Company shall have obtained all third-party consents required under the Material Contracts listed on Schedule 2.4(d) to the Disclosure Schedule.

6.3 Redemption Agreement. Consummation of the transaction contemplated by the Redemption Agreement.

6.4 No Material Adverse Change. Since the date of this Agreement, no event, occurrence or development of a state of circumstances or facts shall have occurred which has had or reasonably could be expected to have a material adverse effect on the Company.

6.5 No Prohibition. no judgment, decree or order shall be in effect that would prevent the carrying out of this Agreement or any of the transactions contemplated hereby, declare unlawful the transactions contemplated hereby or cause such transactions to be rescinded.

7. CONDITIONS PRECEDENT TO THE OBLIGATIONS OF SELLERS.

The obligations of Sellers hereunder are subject to the satisfaction at or prior to the Closing of the following conditions, unless waived in writing by the Shareholders Representative:

7.1 Representations and Warranties; Covenants. Each of the representations and warranties of Buyer shall be true and correct on and as of the Closing. Each of the terms, covenants and agreements to be complied with or performed by Buyer on or before the Closing shall have been complied with and performed. Seller will have received a certificate executed by the Chief Executive Officer of the Buyer confirming the above.

7.2 No Material Adverse Change. Since the date of this Agreement, no event, occurrence or development of a state of circumstances or facts shall have occurred which has had or reasonably could be expected to have a material adverse effect on the business of Buyer that could reasonably be expected to have a material adverse impact on Company after the Closing.

8. CLOSING.

8.1 Place and Date of Closing. The consummation of the transactions contemplated by this Agreement (the “Closing”) is to take place at the offices of Buyer located at 1700 Carnegie Avenue, Suite 100, Santa Ana, California 92705 (it being understood that the Closing may occur remotely by mail, fax, or electronic communication) the later of (A) January 3, 2011 and (B) within two business days following the satisfaction of the conditions to Closing set for in Section 6 and Section 7, unless otherwise extended by Buyer and Shareholders Representative (the day of the Closing, referred to herein as the “Closing Date”).

8.2 Actions at Closing. At the Closing, the following Persons shall deliver or cause to be delivered to following:

(a) Buyer shall deliver the Net Closing Cash Payment to the Shareholders Representative (for further distribution to the Sellers in accordance with Schedule 8.2(a)) by wire transfer of immediately available funds to the account designated by the Shareholders Representative prior to Closing.

(b) Sellers shall deliver to Buyer certificates representing the Shares together with appropriate stock powers.

(c) A release shall be provided for all UCC financing statements and other encumbrances filed against the Assets.

9. INDEMNIFICATION.

9.1 General.

(a) From and after the Closing, the Individual Sellers shall jointly and severally defend, indemnify and hold harmless Buyer, in accordance with each such Individual Seller's Indemnification Percentage set forth on Schedule 9.1 (the "**Indemnification Percentage**"), from, against and in respect of any and all claims, losses, costs, expenses, obligations, liabilities, damages, recoveries and deficiencies, including interest, penalties and reasonable attorneys' fees ("**Losses**") that Buyer may incur, sustain or suffer as a result of (i) any breach of any representation, warranty, covenant or agreement of the Company or the Sellers contained in this Agreement, (ii) the termination of any Company Plans pursuant to Section 2.14(f), (iii) any Company Indebtedness not taken into account for purposes of calculating the Closing Cash Payment; (iv) the amount by which the GDOT 511 Contract operating and maintenance costs incurred through the Closing Date exceed the income generated with respect to the GDOT 511 Contract through the Closing Date; (v) the amount by which the GDOT 511 Contract operating and maintenance costs incurred during the first 12-month period after the Closing exceed the income generated with respect to the GDOT 511 Contract the same period; (vi) the amount that the Company's liability for unpaid sick leave and vacation as of the Closing Date exceeds [***], but only to the extent that such excess is not taken into account in calculating the Closing Cash Payment; and (vii) any claim, demand, action, suit, litigation, dispute, audit, inquiry assessment, grievance, investigation or other proceeding (each a "**Proceeding**") against the Company to the extent that the facts, circumstances or events giving rise to or service as a basis for the commencement of such Proceeding were in existence on or prior to the Closing Date.

(b) From and after the Closing, Public Seller shall defend, indemnify and hold harmless Buyer from, against and in respect of any Losses that Buyer may incur, sustain or suffer as a result of any breach of any representation, warranty, covenant or agreement of such Seller contained in this Agreement.

(c) From and after the Closing, Buyer shall defend, indemnify and hold harmless the Sellers from, against and in respect of any and all Losses that the Sellers may incur, sustain or suffer as a result of any breach of any representation, warranty, covenant or agreement of the Buyer contained in this Agreement.

9.2 Claims for Indemnity. The indemnified party shall endeavor to notify the indemnifying party in writing within thirty (30) business days of the indemnified party's first receipt of notice of, or the indemnified party's obtaining actual knowledge of, such claim, and in any event within such shorter period as may be necessary for the indemnifying party or parties to take appropriate action to resist such claim; provided, however, that the failure to notify or delay in notifying the Shareholder Representative or Buyer, as the case may be, will not relieve the indemnifying party of its obligations pursuant to Section 9.1(a) or (b), except to the extent that such claim is materially prejudiced as a result thereof. Such notice shall specify all facts known to the indemnified party giving rise to such indemnity rights and shall estimate (to the extent reasonably possible) the amount of potential liability arising therefrom. If the indemnifying party shall be duly notified of such dispute, the parties shall attempt to settle and compromise the same or may submit the same to arbitration in accordance with Section 15.3 below or, if unable or unwilling to do any of the foregoing, such dispute shall be settled by appropriate litigation, and any rights of indemnification established by reason of such settlement, compromise, arbitration or litigation shall promptly thereafter be paid and satisfied by those indemnifying parties obligated to make indemnification hereunder.

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

9.3 Right to Defend. If the facts giving rise to any claim for indemnification shall involve any actual or threatened action or demand by any third party against the indemnified party or any of its Affiliates, except as otherwise provided in this Section 9.3, the indemnifying party or parties shall be entitled (without prejudice to the indemnified party's right to participate at its own expense through counsel of its own choosing), at their expense and through counsel of their own choosing, upon written notice to the indemnified party, and using counsel reasonably satisfactory to the indemnified party, to defend such claim in the name of the indemnifying party or parties, or any of them, or if necessary, in the name of the indemnified party, provided that the indemnifying party has unconditionally acknowledged to the indemnified party in writing its obligation to indemnify the Persons to be indemnified hereunder with respect to such third person claim and to discharge any cost or expense arising out of such investigation, contest or settlement. The indemnifying party must obtain the prior written consent of the indemnified party (which will not be unreasonably withheld) prior to entering into any settlement of any claim or proceeding or ceasing to defend any claim or Proceeding unless the proposed settlement involves only the payment of money damages and does not impose an injunction or other equitable relief on the indemnified party. Notwithstanding anything to the contrary in this Agreement, in connection with any third party claim, the indemnifying party shall not be entitled to assume control of such defense and shall pay the reasonable fees and expenses of counsel retained by the indemnified party if the indemnified party shall reasonably conclude that (i) the claim for indemnification relates to or arises in connection with any criminal proceeding, action, indictment, allegation or investigation; (ii) the claim seeks an injunction or equitable relief against the indemnified party; (iii) the indemnified party reasonably believes an adverse determination with respect to the action, lawsuit, investigation, proceeding or other claim giving rise to such claim for indemnification would be detrimental to or injure the indemnified party's reputation or future business prospects; (iv) upon petition by the indemnified party, the appropriate court rules that the indemnifying party failed or is failing to vigorously prosecute or defend such claim; (v) there is a threat of any relief other than solely monetary damages being granted, (vi) in the opinion of the indemnified party's legal counsel, there is a conflict of interest between the indemnifying party and the indemnified party in the conduct of the defense of such third party claim or (vii) there are specific defenses available to the indemnified party which are different from or additional to those available to the indemnifying party and which could be materially adverse to the indemnifying party

9.4 Set-Off. Buyer shall be entitled to set-off (i) any amount that Buyer claims a Seller owes it under this Agreement against (ii) any amounts owed by Buyer to such Seller under this Agreement, including without limitation, any amounts owed and payable by Buyer pursuant to Section 1.2.

9.5 No Waiver. The representations and warranties of Sellers and the Company shall not be affected or deemed waived by reason of any investigation made by or on behalf of the Buyer (including but not limited to any of its representatives) or by reason of the fact that Buyer or any of its representatives knew or should have known that any such representation or warranty is or might be inaccurate.

10. SHAREHOLDERS REPRESENTATIVE.

10.1 Shareholders Representative Appointment and Duties. Kathy J. Osborne (or any successor thereto appointed in accordance with Section 10.2) (the "Shareholders Representative"), is hereby appointed the exclusive agent, proxy and attorney-in-fact for each Seller. The Shareholders Representative shall have the authority to act for and on behalf of Sellers, including, without limitation, (i) to consummate the transactions contemplated herein (with such modifications or changes therein as

to which the Shareholders Representative, in its sole discretion, shall have consented), (ii) to receive and deliver to Buyer surrendered certificates representing the Shares, (iii) to communicate to, and receive all communications and notices from, Buyer, (iv) to do each and every act, implement any decision and exercise any and all rights which Sellers are permitted or required to do or exercise under this Agreement or any documents delivered pursuant to this Agreement, (v) to execute and deliver on behalf of such Sellers any amendment or waiver hereto, (vi) to negotiate, settle, compromise and otherwise handle any post-closing adjustments and all claims for indemnification made by Buyer, (vii) to agree to, negotiate, enter into settlements and compromises of, and commence, prosecute, participate in, settle, dismiss or otherwise terminate, as applicable, any litigation, action, proceeding or investigation relating to the Company, the Shares, Sellers, this Agreement, the Transaction Documents or any of the transactions contemplated by this Agreement or the Transaction Documents, and to comply with orders of courts and awards of courts, mediators and arbitrators with respect to such litigation, action, proceeding or investigation, and (viii) to make, execute, acknowledge and deliver all such other agreements, guarantees, orders, receipts, endorsements, notices, requests, instructions, certificates, stock powers, letters and other writings, and, in general, to do any and all things and to take any and all actions that the Shareholders Representative, in its sole discretion, may consider necessary or proper or convenient in connection with or to carry out the transactions contemplated by this Agreement and the Transaction Documents. The Shareholders Representative shall, in this regard, have all of the rights and powers which Sellers would otherwise have, and Sellers agree that Buyer shall be entitled to rely exclusively upon all actions taken or omitted to be taken by the Shareholders Representative pursuant to this Agreement and any of the foregoing matters. The Shareholders Representative shall for all purposes be deemed the sole authorized agent of Sellers until such time as the agency is terminated. Each Seller agrees that such agency and proxy are coupled with an interest, are therefore irrevocable without the consent of the Shareholders Representative and shall survive the death, incapacity, bankruptcy, dissolution or liquidation of any Seller. All decisions and actions by the Shareholders Representative shall be binding upon all Sellers, and no such Seller shall have the right to object, dissent, protest or otherwise contest the same.

10.2 Resignation or Removal of the Shareholders Representative. The Shareholders Representative may be removed at any time upon a vote of Sellers holding a majority of the Shares (and, if after the Closing, as of immediately prior to the Closing). Subject to the appointment and acceptance of a successor Shareholders Representative as provided below, the Shareholders Representative may resign at any time thirty (30) days after giving notice thereof to Sellers. Upon any such removal or resignation, the retiring Shareholders Representative may, on behalf of Sellers, appoint a successor Shareholders Representative; provided, however, that if the retiring Shareholders Representative is unwilling or unable to appoint a successor Shareholders Representative, Sellers may appoint a successor Shareholders Representative by a vote of Sellers holding a majority of the Shares (and, if after the Closing, as of immediately prior to the Closing). Upon the acceptance of any appointment as the Shareholders Representative hereunder, such successor Shareholders Representative shall thereupon succeed to and become vested with all the rights, powers, privileges and duties of the retiring Shareholders Representative, and the retiring Shareholders Representative shall be discharged from its duties and obligations hereunder. After any retiring Shareholders Representative's resignation or removal hereunder as the Shareholders Representative, the provisions of Section 10.3 shall continue in effect for such retiring Shareholders Representative's benefit in respect of any actions taken or omitted to be taken by it while it was acting as the Shareholders Representative.

10.3 Liability of Shareholders Representative. The Shareholders Representative shall not incur any liability to Sellers with respect to any action taken in reliance upon any note, direction, instruction, consent, statement or other document believed by the Shareholders Representative to be genuinely and duly authorized, or for any other action or inaction in its capacity as the Shareholders Representative, excepting only the fraud or willful misconduct of the Shareholders Representative. The Shareholders Representative may, in all questions arising hereunder, rely on the advice of legal counsel and for anything done, omitted or suffered in good faith by the Shareholders Representative based on such advice, the Shareholders Representative shall not be liable to any Seller while acting in its capacity as Shareholders Representative. Each Individual Seller shall be liable, pro rata in accordance with such Individual Seller's Indemnification Percentage, for any expenses (including, without limitation, reasonable attorneys' fees and expenses) paid or incurred by the Shareholders Representative in connection with the performance of its obligations as Shareholders Representative, including in the defense of any indemnification claim brought against Sellers under Section 9.

11. TERMINATION.

11.1 Grounds for Termination. This Agreement may be terminated at any time prior to the Closing:

- (a) by mutual written agreement of the Company and Buyer;
- (b) by either the Company or Buyer, either of whom may act, if the Closing shall not have been consummated on or before January 31, 2011 ("Termination Date"). The right to terminate this Agreement under this Section 11.1 (b) shall not be available to any party whose failure or whose Affiliate's failure to perform any material obligation under this Agreement is the cause of such delay;
- (c) by either the Company or Buyer, either of whom may act, if there shall be any law or regulation that makes consummation of the transactions contemplated hereby illegal or otherwise prohibited or if consummation of the transactions contemplated hereby would violate any nonappealable final order, decree or judgment of any court or governmental body having competent jurisdiction;
- (d) by the Company, provided the Company is not then in breach of any of its obligations hereunder, if either (i) Buyer fails to perform any covenant contained in this Agreement when performance thereof is due and does not cure the failure within twenty (20) days after the Company delivers written notice thereof, or (ii) any condition in Section 7.1 has not been satisfied and is not capable of being satisfied prior to the Termination Date; or
- (e) by Buyer, provided that Buyer is not then in breach of any of its obligations hereunder, if either (i) the Company fails to perform any covenant contained in this Agreement when performance thereof is due and does not cure the failure within twenty (20) days after Buyer delivers written notice thereof, or (ii) any condition in Section 6.2 or Section 6.4 has not been satisfied and is not capable of being satisfied prior to the Termination Date.

The party desiring to terminate this Agreement pursuant to this Section 11 shall give written notice of such termination to the other party.

11.2 Effect of Termination. If this Agreement is terminated as permitted by Section 11.1, such termination shall be without liability of any party (or any shareholder, director, officer, employee, agent, consultant or representative of such party) to any other party to this Agreement, except to the extent that such termination results from the willful and material breach by a party hereto of any representation, warranty or covenant contained in this Agreement. The provisions of Sections 12, 13 and 14 and this Section 9.2 shall survive any termination of this Agreement pursuant to Section 11.1.

12. COSTS.

12.1 Finder's or Broker's Fees. Each of Buyer, Company and Sellers represents and warrants to the other that neither they nor any of their respective Affiliates have dealt with any broker or finder in connection with any of the transactions contemplated by this Agreement, and no broker or other person is entitled to any commission or finder's fee in connection with any of these transactions.

12.2 Expenses. Buyer and Sellers shall each pay all of their own costs and expenses incurred or to be incurred by them, respectively, in negotiating and preparing this Agreement and in closing and carrying out the transactions contemplated by this Agreement.

12.3 Attorneys' Fees. Except as otherwise provided in Section 13.3 below, if a party hereto brings an action, arbitration or court proceeding to enforce the terms hereof or declare rights hereunder, the prevailing party in any such action, arbitration, trial or appeal thereon, shall be entitled to its reasonable attorneys' fees to be paid by the losing party as fixed by the court or arbitrator in the same or separate action, and whether or not such action is pursued to decision or judgment.

13. PARTIES.

13.1 Parties in Interest. Nothing in this Agreement, whether expressed or implied, is intended to confer any rights or remedies under or by reason of this Agreement on any persons other than the parties to it and their respective successors and permitted assigns, nor is anything in this Agreement intended to relieve or discharge the obligations or liability of any third persons to any party to this Agreement, nor shall any provision give any third persons any right of subrogation or action over or against any party to this Agreement.

13.2 Notices. All notices, requests, demands and other communications under this Agreement shall be in writing and shall be deemed to have been duly given on the date of service if served personally on, telecopied to or electronically delivered to the party to whom notice is to be given with confirmation of receipt and deposit of a copy of such telecopy or electronic delivery in the mail, one day after being deposited for overnight delivery with a recognized overnight courier service in a properly addressed package with all charges prepaid or billed to the account of the sender, or on the third day after mailing if mailed to the party to whom notice is to be given, by first class mail, registered or certified, postage prepaid, and properly addressed:

- (a) if to Company or Shareholders Representative prior to the Closings, to:

Meridian Environmental Technology, Inc.
4324 University Avenue, Suite B
Grand Forks, ND 58203-1938

Attention: Ms. Kathy J. Osborne
Tel. No.: (701) 792-1800
Fax No.: (701) 792-1831
E-mail: kathyo@meridian-enviro.com

After the Closing, to:

(b) if to the Shareholders Representative after the Closing, to:

Ms. Kathy J. Osborne
c/o Camrud Maddock Olson & Larson Ltd.
401 DeMers Avenue, Suite 500
Grand Forks, ND 58206-5849

Tel. No.: (701) 775-5595
Fax No.: (701) 772-3743
E-mail: kathyo@meridian-enviro.com

and

(c) if to Buyer, to:

Iteris, Inc.
1700 Carnegie Avenue, Suite 100
Santa Ana, California 92705

Attn: Dan Gilliam
Tel. No.: 949.270.9606
Fax No.: 949.270.9401
E-mail: dgilliam@iteris.com

or to such other address as shall have been specified by notice in writing given to either or both other parties.

14. MISCELLANEOUS.

14.1 Amendments and Modifications. No amendment or modification of this Agreement or any Exhibit or Schedule hereto shall be valid unless made in writing and signed by the Buyer, the Company and Shareholder Representative.

14.2 Non-Assignability; Binding Effect. Neither this Agreement, nor any of the rights or obligations of the parties hereunder, shall be assignable by any party hereto without the prior written consent of all other parties hereto, except that Buyer may, without requirement of any consent of Company and Sellers, assign Buyer's rights to indemnification under Section 9 to any secured lender to Buyer from time to time provided that such lender shall have no rights greater than those of Buyer hereunder.

14.3 Governing Law; Jurisdiction. This Agreement shall be construed and interpreted and the rights granted herein governed in accordance with the laws of the State of California applicable to contracts made and to be performed wholly within such State. Except as otherwise provided in Section 9 above, any claim, dispute or controversy arising under or in connection with this Agreement or any actual or alleged breach hereof shall be settled exclusively by arbitration in Orange County, California. As part of his or her award, the arbitrator shall make a fair allocation of his or her fee, the cost of any transcript, and the parties' reasonable attorneys' fees, taking into account the merits and good faith of the parties' claims and defenses. Judgment may be entered on the award so rendered in any court having jurisdiction. Any process or other papers hereunder may be served by registered or certified mail, return receipt requested, or by personal service, provided that a reasonable time for appearance or response is allowed.

14.4 Execution of Agreement. This Agreement may be executed in one or more counterparts, each of which will be deemed to be an original copy of this Agreement and all of which, when taken together, will be deemed to constitute one and the same agreement. The exchange of copies of this Agreement and of signature pages by facsimile or electronic transmission shall constitute effective execution and delivery of this Agreement as to the parties and may be used in lieu of the original Agreement for all purposes. Signatures of the parties transmitted electronically or by facsimile shall be deemed to be their original signatures for all purposes.

14.5 Effect of Headings. The Section headings used in this Agreement and the titles of the Schedules hereto are included for purposes of convenience only, and shall not affect the construction or interpretation of any of the provisions hereof or of the information set forth in such Schedules.

14.6 Entire Agreement; Waivers. This Agreement (including the Schedules and Exhibits hereto) constitutes the entire agreement between the parties pertaining to the subject matter hereof, and supersedes all prior agreements or understandings as to such subject matter. No party hereto has made any representation or warranty or given any covenant to the other except as set forth in this Agreement and the Schedules and Exhibits hereto. No waiver of any of the provisions of this Agreement shall be deemed, or shall constitute, a waiver of any other provisions, whether or not similar, nor shall any waiver constitute a continuing waiver. No waiver shall be binding unless executed in writing by the party making the waiver.

14.7 Further Assurances. From time to time from and after the Closing, the parties will take any and all such action and execute and deliver to one another any and all further agreements, instruments, certificates and other documents, as may reasonably be requested by any other party in order more fully to consummate the transactions contemplated hereby, and to effect an orderly transition of the ownership and operations of the Assets

[Signatures on following pages.]

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first set forth above.

Buyer:

Iteris, Inc.

By: /s/ Abbas Mohaddes
Name: Abbas Mohaddes
Title: Chief Executive Officer

Company:

Meridian Environmental Technology, Inc.

By: /s/ Leon F. Osborne, Jr.
Name: Leon F. Osborne, Jr.
Title: Chief Executive Officer

[SIGNATURE PAGE TO STOCK PURCHASE AGREEMENT]

Sellers:

/s/ Leon F. Osborne, Jr.
Leon F. Osborne, Jr.

/s/ Kathy J. Osborne
Kathy J. Osborne

/s/ Mark Owens
Mark Owens

/s/ Bryan Hahn
Bryan Hahn

/s/ John Mewes
John Mewes

/s/ Cory Block
Cory Block

The UND Aerospace Foundation

By: /s/ Bruce Allan Smith

Name: Bruce Allan Smith

Title: President/CEO

Shareholders Representative:

/s/ Kathy J. Osborne
Kathy J. Osborne

[SIGNATURE PAGE TO STOCK PURCHASE AGREEMENT]

Schedule 1.2
Adjustments to Base Purchase Price

(a) Adjustments to Closing Cash Payment.

(i) Cash & Accounts Receivable = \$1,600,000.

This Agreement contemplates that at the Closing the amount of cash will be \$900,000 and the amount of accounts receivable (including unbilled receivables) will be \$700,000. The Closing Cash Payment will be reduced by the exact amount (if any) that the sum of cash and accounts receivable is less than \$1,600,000 and will be increased by the exact amount (if any) that the sum of cash and accounts receivable is more than \$1,600,000.

(ii) Accounts Payable = \$100,000

This Agreement contemplates (A) that prior to the Closing the final installments totaling [***] for the Loquendo license (LDE-072909MBMeridian) shall have been paid; and (B) at the Closing the amount of accounts payable will be \$100,000. The Closing Cash Payment will be reduced by the exact amount (if any) that the total accounts payable exceeds \$100,000 and will be increased by the exact amount (if any) that the total accounts payable is less than \$100,000.

(iii) Backlog Adjustment

This Agreement contemplates that at the Closing total Backlog will be [***]. The Closing Cash Payment will be reduced by an amount equal to 15% of the amount that Backlog is less than [***].

(iv) Unpaid Sick Leave and Vacation

This Agreement contemplates that the liability for earned but unpaid Sick Leave and Vacation shall not exceed [***] at the Closing. The Closing Cash Payment will be reduced by an amount equal to the amount that such liability exceeds [***].

(v) Employee 2010 Bonuses Holdback

This Agreement contemplates that, prior to the Closing, the employees of the Company shall have been paid bonuses awarded at the Company's discretion to reflect each employee's contribution to the Company's success for the 2010 calendar year. In the event that such bonuses have not been paid prior to the Closing, an amount of [***] (the "**Employee 2010 Bonuses Holdback**") shall be withheld from the Closing Cash Payment to enable Buyer to make payments in lieu of the Company. In the event that the Employee 2010 Bonuses Holdback exceeds the amount actually paid by Buyer to employees after the Closing, such excess amount shall be paid to the Shareholders Representative (for further distribution to the Sellers) within a commercially reasonable time after payment of employees has been made.

(vi) Georgia Department of Transportation 511 Contract ("**GDOT 511 Contract**") Holdback

This Agreement contemplates that, at the Closing, obligations may remain for payment of up to [***] for operating and maintenance costs for the GDOT 511 Contract that ended October 31, 2010 that exceeded income generated from a combination of sponsorships and advertising through October 31, 2010. Therefore, in order to reserve funds for payment after Closing of these obligations incurred prior to the Closing, an amount of [***] (the "**GDOT 511 Holdback**") shall be withheld from the Closing Cash Payment to cover the obligations. In the event that the GDOT 511 Holdback exceeds the amount actually paid by Seller to discharge these obligations prior to March 31, 2011, such excess amount shall be paid to the Shareholders Representative (for further distribution to the Sellers, Pro Rata) within a commercially reasonable time after issuance of Buyer SEC Form 10-K for the period ended March 31, 2011.

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

(b) Adjustments to First Deferred Payment.

(i) GDOT Contract

This Agreement contemplates that the operating and maintenance costs for the GDOT 511 Contract will be [***] during the first 12-month period after the Closing and that the Company will conduct this business in the ordinary course consistent with past practices prior to the Closing. It is expected that income generated from a combination of sponsorships and advertising during this same time frame will cover the operating and maintenance costs and provide revenue for GDOT 511 Contract participants. Should the GDOT 511 Contract income sources fail to generate adequate income to cover the lesser of 1) the expected operating and maintenance expenses, or 2) the actual operating and maintenance expenses for the GDOT 511 Contract during this period, the First Deferred Payment shall be reduced by fifty percent (50%) of the amount such operating and maintenance costs exceed the income received and the remaining 50% shortfall in income (the “**GDOT 511 Shortfall Amount**”) will be carried over to the Second Deferred Payment. Since such amounts will not be known on the 12-month anniversary date of the Closing, an amount of [***] (the “**GDOT 511 12-Month Holdback**”) shall be withheld from the First Deferred Payment to cover such excess operation and maintenance costs. In the event that 50% of the GDOT 511 Contract excess operating and maintenance costs through the 12-month anniversary date of the Closing are less than the GDOT 511 12-Month Holdback, such amount shall be paid to the Shareholders Representative (for further distribution to the Sellers, Pro Rata) within a commercially reasonable time after issuance of Buyer SEC Form 10-K for the period ended March 31, 2012.

(ii) MDSS First Year License Adjustment

As set forth in that certain Settlement and License Agreement effective as of October 29, 2010 between the Company and Concaten, Inc. and IWAPI, Inc. (“**Concaten**”), the Company is obligated to pay a license fee (the “**Concaten License Fee**”) for each road maintenance vehicle equipped with an AVL system used for providing Company’s MDSS services. This Agreement contemplates that the total Concaten License Fee payable to Concaten from the Closing through the end of the 2010 - 2011 season for which MDSS services are provided, will be less than or equal to [***]. The First Year Deferred Payment shall be reduced by the “**MDSS First Year License Adjustment**”, which shall be the lesser of (A) [***] or (B) the total Concaten License Fee paid to Concaten from Closing through the end of the 2010 – 2011 season less the amount of such fees paid by pass-through of the Concaten License Fee to the Company’s MDSS clients or customers.

(iii) Adjustments Based Upon Key Employees

1) Definitions

“**Discharge for Cause**” means the Company’s termination of a Key Employee’s employment for any one or more of the following: (i) such Key Employee’s participation in an act of willful dishonesty, fraud or misconduct with respect to the business or affairs of the Company or its Affiliates; (ii) material wrongful disclosure of the confidential information of the Company or its Affiliates or their respective customers or clients; (iii) such Key Employee’s failure to provide exclusive business time and services for the benefit of the Company which includes, but is not limited to, such Key Employee’s unapproved relocation from the area in

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

reasonable proximity to the principal place of employment, such Key Employee's refusal to work on projects and services assigned to such Key Employee by the Company, or the failure of such Key Employee to provide the number of productive hours provided by other employees of the Company of similar grade and function, as determined by the Company; (iv) intoxication, illegal drug use, excessive absenteeism that may materially interfere with such Key Employee's job performance or the Company's business; (v) such Key Employee's gross negligence in the performance of, or intentional nonperformance of, such Key Employee's duties and responsibilities that has not been cured within thirty (30) days following written notice from the Company to such Key Employee; (vi) any conviction of or a plea of "guilty" or "no contest" to a felony; or (vii) such Key Employee's material breach of the provisions of the Iteris Employment Agreements, which breach continues and is not remedied by such Key Employee within thirty (30) days following written notice from the Company to such Key Employee.

"Default Event" means the termination of the Key Employee's employment with Buyer (i) by Buyer without Cause or (ii) by Key Employee for Good Reason.

"Termination for Good Reason" means a Key Employee's voluntary termination of employment with the Company if, without the prior consent of such Key Employee: (i) there is a reduction by the Company in such Key Employee's annual salary except any reductions generally affecting similarly situated employees of the Company; or (ii) there is a relocation of such Key Employee to a facility or location more than fifty (50) miles from the Company's current location.

"Key Employee" shall have the meaning set forth I Section 6.1 of this Agreement

- 2) If, within 12 months after the Closing, a Key Employee terminates his/her employment other than pursuant to a Termination for Good Reason or Buyer terminates a Key Employee's employment pursuant to a Discharge for Cause, then the amount of the First Deferred Payment will be reduced by the percentage specified for such Key Employee listed below adjusted proportionally to the number of months the Key Employee remained a full time employee during the year. The total percentage reduction cannot exceed 100%.

[***]

(c) Adjustments to Second Deferred Payment.

(i) GDOT Contract

Should there be a GDOT 511 Shortfall Amount as defined in Section (b)(i) above, the Second Deferred Payment shall be reduced by the amount of such the GDOT 511 Shortfall Amount, not to exceed [***].

(ii) MDSS Second Year License Adjustment

This Agreement contemplates that the total Concaten License Fee payable to Concaten for the 2011 – 2012 season for which MDSS services are provided will be less than or equal to [***]. The Second Year Deferred Payment shall be reduced by the **"MDSS Second Year License Adjustment"**, which shall be the lesser of (A) [***] and (B) the total Concaten License Fee paid to Concaten for the 2011 – 2012 season less the amount of such fee paid by pass-through of the Concaten License Fee to the Company's MDSS clients or customers.

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

(iii) Adjustments Based Upon Key Employees

1) Definitions

Same as Section (b)(iii)(1) above.

- 2) If, within the period from 12 to 24 months after Closing, a Key Employee terminates his/her employment other than pursuant to a Termination for Good Reason or Buyer terminates a Key Employee's employment pursuant to a Discharge for Cause, then the amount of the Second Deferred Payment will be reduced by the percentage specified for such Key Employee listed below adjusted proportionally to the number of months the Key Employee remained a full time employee during the year. The total percentage reduction cannot exceed 100%.

[***]

(d) Additional Consideration.

- (i) Subject to the provisions below, Company shall be eligible to receive the Additional Consideration in accordance with this Schedule 1.2(d).

- (ii) As used in this Schedule 1.2(d), the terms set forth below shall have the following meanings:

“**Revenue**” shall mean gross revenue (as calculated in accordance with United States generally accepted accounting principles) of the Company less discounts and returns.

“**Revenue Goal**” shall mean the estimated Revenue in Year 1 or Year 2 as set forth in Subsection (iii) below.

“**Operating Income**” shall mean Revenue less cost of sales and operating expenses calculated in accordance with GAAP.

“**Operating Income Goal**” shall mean the estimated Operating Income in Year 1 or Year 2 as set forth in Subsection (iii) below.

“**Year 1**” shall mean the 12-month fiscal period beginning with the start of the first fiscal quarter after the Closing (January 2011 through December 2011).

“**Year 2**” shall mean the 12-month fiscal period beginning with the start of the first fiscal quarter after Year 1 (January 2012 through December 2012).

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

(iii) Revenue Goals and Operating Income Goals for Year 1 and Year 2 are as set forth in the following table:

	Year 1	Year 2
Revenue Goals	[***]	[***]
Operating Income Goals	[***]	[***]

(iv) The Additional Consideration that may be earned in each of Year 1 and Year 2 is One Million Dollars (\$1,000,000) of which [***] in each year is subject to the achievement of that year’s Revenue Goal and [***] in each year is subject to the achievement of that year’s Operating Income Goal. Additional Consideration in each of Year 1 and Year 2 is based upon the actual Revenue and Operating Income during the year determined from audited or reviewed corporate financial records. Additional Consideration Factors for both Revenue (“**REV ACF**”) and Operating Income (“**OI ACF**”) are determined from the table below based upon the Goal Achievement percentage. Additional Consideration is then calculated as follows:

Additional Consideration = REV ACF x [***] + OI ACF x [***]

Example: with 96% Revenue Goal Achievement and 105% Operating Income Goal Achievement in Year 1:

Additional Consideration = 68.3% * x [***] + 83% ** x [***] = [***].

Goal Achievement	Additional Consideration Factor	
	Year 1	Year 2
Revenue		
100% to 110% of Goal**	75 - 100%	75% - 100%
85% to 100% of Goal*	50% - 75%	50% - 75%
Less than 85% of Goal	0%	0%
Operating Income		
100% to 110% of Goal**	75% - 100%	75% - 100%
85% to 100% of Goal*	50% - 75%	50% - 75%
Less than 85% of Goal	0%	0%

* Linear equation with 5/3 slope (5/3(0.96 – 0.85) + 0.50 = 0.683)

** Linear equation with 5/2 slope (5/2(1.05-1.00) + 0.75 = 0.83)

(v) As set forth in Section 1.2(d) of this Agreement, Buyer shall pay to the Shareholders Representative (for further distribution to the Sellers in accordance with Schedule A) the Net Additional Consideration earned as calculated in Section (d) above as set forth in accordance with the following schedule:

- 1) For Additional Consideration earned in Year 1, payment shall be within a commercially reasonable time after issuance of Buyer SEC Form 10-K for the period ended March 31, 2012.
- 2) For Additional Consideration earned in Year 2, payment shall be within a commercially reasonable time after issuance of Buyer SEC Form 10-K for the period ended March 31, 2013.

[***] Confidential treatment has been requested for the bracketed portions. The confidential redacted portion has been omitted and filed separately with the Securities and Exchange Commission.

- (vi) Revenue and Operating Income used in the calculations of Section (d) shall be based upon the actual Revenue and Operating Income during Year 1 or Year 2, as the case may be, resulting from the operation of the Business and determined from audited or reviewed corporate financial records. No later than concurrent with the respective payment for Year 1 or Year 2, as applicable, Buyer will provide to the Shareholder Representative a report in writing certifying as to the amount of Revenue and Operating Income attained in such year from the operation of the Business as defined in this Agreement and as to the calculations of Additional Consideration.
- (e) Unless the Shareholder Representative notifies Buyer within 15 days after receipt of the report that it objects to the computations reflected therein, the report shall be binding and conclusive for all purposes of this Schedule 1.2(d). The Shareholder Representative shall have reasonable access to the books and records of Buyer necessary to verify the amount of computations.
- (f) If the Shareholder Representative notifies Buyer in writing within 15 days after receipt of Buyer's report that it objects to the computations set forth therein, the grounds for such objection shall be negotiated in good faith between the Shareholder Representative and Buyer and the corresponding payment shall be adjusted as necessary. If, upon completion of such fifteen (15) day period, Buyer and the Shareholders Representative are unable to reach an agreement, they shall promptly thereafter cause the Independent Accountant to review this Agreement and the disputed items or amounts for the purpose of calculating the Additional Consideration. In making such calculation, the Independent Accountant shall consider only those items or amounts in the Buyer's financial statements for the applicable period as to which Buyer and the Shareholders Representative have disagreed. The Independent Accountant shall deliver to the Shareholders Representative and Buyer, as promptly as practicable, a report setting forth its calculations. Such report shall be final and binding upon Buyer and Sellers. The cost of such review and report shall be paid (i) one-half by Sellers, Pro Rata, and (ii) one-half by Buyer.

Other Schedules**

Schedule 8.1(a) — Allocation of Net Closing Cash Payment

Schedule 9.1 — Individual Shareholder Indemnification Percentages

Schedule A — Allocation of Deferred Payments

Disclosure Schedule

** Iteris, Inc. agrees to furnish supplementally a copy of any omitted schedule to the Securities and Exchange Commission upon request.

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Abbas Mohaddes, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Iteris, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 14, 2011

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

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James S. Miele, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Iteris, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 14, 2011

/s/ JAMES S. MIELE

James S. Miele
Chief Financial Officer

(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Iteris, Inc. (the "Company") on Form 10-Q for the quarter ended December 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Abbas Mohaddes, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ABBAS MOHADDES

Abbas Mohaddes
Chief Executive Officer

February 14, 2011

A signed original of this written statement required by Section 906, or any other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Iteris, Inc. (the "Company") on Form 10-Q for the quarter ended December 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James S. Miele, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JAMES S. MIELE
James S. Miele
Chief Financial Officer

February 14, 2011

A signed original of this written statement required by Section 906, or any other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
