ITERIS HOLDINGS INC
Form 424B3
February 25, 2004

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FILED PURSUANT TO RULE 424(B)(3)
REG. STATEMENT NO. 333-110344

4,533,332 Shares

ITERIS HOLDINGS, INC.

Class A Common Stock

This prospectus relates to the offering from time to time of a total of 4,533,332 shares of the Class A common stock of Iteris Holdings, Inc., formerly known as Odetics, Inc., a Delaware corporation or interests therein by the selling stockholders listed on page 46 and their transferees. All of these shares were issued or are issuable to the selling stockholders in connection with a private placement completed in July 2003 or in connection with the July 2003 restructuring of the lease for our principal operating facilities located in Anaheim, California. The prices at which the selling stockholders may sell their shares will be determined by the prevailing market price for their shares or in negotiated transactions. We will not receive any of the proceeds from the sale of these shares.

We have two classes of common stock outstanding: Class A common stock and Class B common stock. The rights, preferences and privileges of each class of common stock are identical in all respects except for voting and conversion rights. As of the date of this prospectus, the holders of the Class A common stock are entitled to elect 25% of the Board of Directors rounded up to the nearest whole number, or two directors, and the holders of the Class A common stock and the Class B common stock, voting together as a single class, are entitled to elect the balance of the Board, or six directors. On all other matters to be addressed by a stockholder vote, the holders of Class A common stock have one-tenth of one vote per share held and the holders of Class B common stock have one vote per share held. In addition, each share of Class B common stock is convertible into one share of Class A common stock at the option of the holder of such Class B common stock.

Our Class A common stock and our Class B common stock are quoted on the OTC Bulletin Board under the symbols "ITRSA.OB" and "ITRSB.OB," respectively. On February 13, 2004, the last reported sale price for the Class A common stock was $2.65 per share. The last reported sale of the Class B common stock occurred on February 11, 2004 at a price of $2.15 per share.

You should carefully consider the risk factors beginning on page 5 of this prospectus before purchasing any of the Class A common stock offered by this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities, or passed on the accuracy or adequacy of the disclosures in this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is February 25, 2004.

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We have not authorized any person to make a statement that differs from what is in this prospectus. If any person does make a statement that differs from what is in this prospectus, you should not rely on it.

PROSPECTUS SUMMARY

This summary highlights selected information in this document and may not contain all of the information that is important to you. You should carefully read the entire prospectus, including "Risk Factors" and the consolidated financial statements and related notes, before making an investment decision. This summary and the balance of this document contain forward-looking statements about events that are not certain to occur, and you should not place undue reliance on those statements. Please carefully read "Forward-Looking Statements" at page 13 of this document. The information in this prospectus is complete and accurate as of its date, but the information may change after that date. Unless otherwise indicated, references to "we," "us" and "our" are references to Iteris Holdings, Inc. and its subsidiaries.

Our Company

Iteris Holdings, Inc., formerly known as Odetics, Inc., is the majority stockholder of Iteris, Inc., a leading provider of outdoor machine vision systems, sensors and consulting services that optimize the flow of traffic and enhance driver safety. Leveraging our expertise in video image processing, we entered into the intelligent transportation systems ("ITS") business in 1993 with the introduction of a video-based vehicle detection system. In June 1997, we acquired certain assets comprising the Transportation Systems business from Rockwell International, creating our ITS division, which expanded our offerings to include advanced traffic management systems and advanced traveler information systems. We incorporated our ITS division as Odetics ITS, Inc. and broadened our systems offerings by acquiring Meyer, Mohaddes Associates, Inc. in 1998. In January 2000, we reincorporated Odetics ITS in Delaware and changed its name to Iteris, Inc. As of December 31, 2003, Iteris Holdings owned 74.5% of the outstanding common stock of Iteris, Inc. and 59.1% of the common stock of Iteris, Inc., assuming full conversion of the outstanding Series A preferred stock of Iteris, Inc. We currently operate Meyer, Mohaddes Associates, Inc. as a wholly-owned subsidiary of Iteris, Inc.

We historically operated multiple business units including MAXxess Systems, Inc., formerly known as Gyyr Incorporated, which designed and manufactured security management systems; Zyfer, Inc., which developed and manufactured timing and synchronization products; and Broadcast, Inc., which developed and supplied software-based systems to automate and control the multiple classes of equipment used in broadcast studios and satellite uplink facilities. Beginning in late 2001, we began divesting certain of our business units in order to reduce our operating expenses and to focus on what we believe is our core business Iteris, Inc. In September 2001, we sold the assets of our Gyyr Closed Circuit Television Products line, which included video recorders and equipment that facilitated video switching and multiplexing. Upon completion of this sale, we changed the name of our Gyyr subsidiary to MAXxess Systems, Inc. In September 2003, we sold substantially all of the assets of MAXxess to an investor group that included certain members of the MAXxess management group. In March 2003, we decided to cease the development and sale of any new Broadcast products and in September 2003, we sold the balance of our Broadcast business. In May 2003, we sold substantially all of the assets of Zyfer.

Iteris Holdings, Inc. was incorporated in Delaware in October 1987 as Odetics, Inc. and changed its name to Iteris Holdings, Inc. in September 2003 in order to communicate our focus on our ITS business. Our Class A common stock and our Class B common stock are currently traded on the OTC Bulletin Board under the symbols "ITRSA.OB" and "ITRSB.OB," respectively. Our principal executive offices are located at 1515 South Manchester Avenue, Anaheim, California 92802, and our telephone number is (714) 774-5000. Our website is www.iteris.com. Information available on our website does not constitute part of this prospectus.

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The Offering

Common stock offered by selling stockholders	4,533,332 shares(1)
Common stock outstanding prior to and after this offering	19,941,839 shares(2)
Use of proceeds	We will not receive any proceeds from sales of the shares offered by this prospectus. However, we will receive the proceeds from the exercise of the warrants by the selling stockholders, and those proceeds are expected to be used for our general corporate purposes. See "Use of Proceeds."
OTC Bulletin Board trading symbols	ITRSA.OB and ITRSB.OB

(1) Consists solely of Class A common stock and includes an aggregate of 441,666 shares of Class A common stock issuable upon exercise of warrants issued in connection with a private placement completed in July 2003 and a warrant issued in connection with the July 2003 restructuring of the lease for our principal operating facilities located in Anaheim, California.

(2) As of December 31, 2003. Includes 19,009,909 shares of Class A common stock and 931,930 shares of Class B common stock. Excludes 3,555,833 shares of Class A common stock issuable upon exercise of outstanding warrants and 1,133,134 shares of Class A common stock issuable upon exercise of outstanding stock options.

Selling Stockholders

The shares of Class A common stock being offered for resale by the selling stockholders pursuant to this prospectus may be offered by them in varying amounts and transactions so long as this prospectus is then current under the rules and regulations of the SEC and the registration statement has not been withdrawn by us. See "Selling Stockholders" on page 46. The offering may be completed through the facilities of the OTC Bulletin Board or such other exchange or reporting system where our Class A common stock may be traded. Brokerage commissions may be paid or discounts allowed in connection with such sales; however, it is anticipated that the discounts allowed or commitments paid will be no more than the ordinary brokerage commissions paid on sales effected through brokers or dealers.

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Summary Consolidated Financial Data

	Fiscal Year Ended March 31,					Nine Months Ended December 31,	
	1999	**2000**	**2001**	**2002**	**2003**	**2002**	**2003**
						(unaudited)	
	(in thousands, except per share data)						
Consolidated Statement of Operations Data:							
Net sales and contract revenues:							
Net sales	$ 4,339	$ 7,740	$ 10,626	$ 17,104	$ 19,112	$ 14,000	$ 17,608
Contract revenues	10,240	15,671	17,430	20,205	22,283	16,510	16,300

	Fiscal Year Ended March 31,					Nine Months Ended December 31,	
Total net sales and contract revenues	14,579	23,411	28,056	37,309	41,395	30,510	33,908
Costs and expenses:							
Cost of net sales	3,129	4,308	5,558	8,401	9,366	6,796	9,491
Cost of contract revenues	7,196	11,310	11,463	12,043	15,110	11,225	11,027
Selling, general and administrative expenses	9,619	15,201	15,882	14,627	14,105	9,351	9,754
Research and development expenses	2,150	3,698	5,526	3,434	3,908	2,758	3,044
Restructuring charges			367	1,142			
Total costs and expenses	22,094	34,517	38,796	39,647	42,489	30,130	33,316
Income (loss) from operations	(7,515)	(11,106)	(10,740)	(2,338)	(1,094)	380	592
Non-operating income (expense):							
Royalty income		38,437	17,825				
Other income (expense), net	323		188	(1,365)	417	640	970
Interest expense, net	(1,807)	(1,919)	(1,762)	(4,190)	(761)	(694)	(92)
Income (loss) before income taxes	(8,999)	25,412	5,511	(7,893)	(1,438)	326	1,470
Income tax benefit (provision)				785			(744)
Income (loss) from continuing operations before minority interest	(8,999)	25,412	5,511	(7,108)	(1,438)	326	726
Minority interest in earnings of subsidiary				(1,910)	(3,818)	(2,992)	(2,518)
Income (loss) from continuing operations	(8,999)	25,412	5,511	(9,018)	(5,256)	(2,666)	(1,792)
Income (loss) from discontinued operations, net of taxes of $0	(11,119)	(27,691)	(38,051)	(17,120)	(7,892)	(2,157)	1,682
Extraordinary loss from early extinguishment of debt, net of taxes of $0				(450)			
Net loss	$ (20,118)	$ (2,279)	$ (32,540)	$ (26,588)	$ (13,148)	$ (4,823)	$ (110)
Basic earnings (loss) per share:							
Continuing operations	$ (1.15)	$ 2.80	$ 0.55	$ (0.80)	$ (0.37)	$ (0.19)	$ (0.10)
Discontinued operations	(1.42)	(3.05)	(3.81)	(1.52)	(0.55)	(0.15)	0.09
Extraordinary loss				(0.04)			
Basic loss per share	$ (2.57)	$ (0.25)	$ (3.26)	$ (2.36)	$ (0.92)	$ (0.34)	$ (0.01)
Diluted earnings (loss) per share							
Continuing operations	$ (1.15)	$ 2.69	$ 0.54	$ (0.80)	$ (0.37)	$ (0.19)	$ (0.10)
Discontinued operations	(1.42)	(2.93)	(3.73)	(1.52)	(0.55)	(0.15)	0.09
Extraordinary loss				(0.04)			
Diluted loss per share	$ (2.57)	$ (0.24)	$ (3.19)	$ (2.36)	$ (0.92)	$ (0.34)	$ (0.01)
Shares used in calculating basic loss per share	7,820	9,089	9,977	11,267	14,276	13,996	17,705
Shares used in calculating diluted loss per share	7,820	9,444	10,209	11,267	14,276	13,996	17,748

	At March 31,					At December 31,	
	1999	2000	2001	2002	2003	2002	2003
						(unaudited)	
				(in thousands)			
Consolidated Balance Sheet Data:							
Working capital (deficit)	$ 26,066	$ 26,830	$ 2,114	$ (7,349)	$ 3,368	$ 11,142	$ 6,907
Total assets	81,355	81,850	68,061	52,238	34,842	40,062	27,934
Long-term debt (less current portion)	19,962	10,649	4,791	2,042	1,265	1,680	902
Accumulated deficit	(23,913)	(26,192)	(58,732)	(85,320)	(98,468)	(90,143)	(98,578)
Total stockholders' equity (deficit)	36,323	36,110	20,378	5,255	(4,288)	(3,169)	(1,597)

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RISK FACTORS

Our business is subject to a number of risks, some of which are discussed below. You should consider the following risks carefully in addition to the risks and information contained elsewhere in this prospectus before purchasing shares of our common stock. The risks and uncertainties described below are not the only ones facing us. 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 occur, 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.

We Have Experienced Substantial Losses And May Continue To Experiencing Losses For The Foreseeable Future. We experienced net losses of $110,000 in the nine months ended December 31, 2003, $13.1 million in the year ended March 31, 2003 and $26.6 million in the year ended March 31, 2002. While we have divested all of our business units other than our Iteris, Inc. subsidiary, we cannot assure you that our efforts to downsize our operations or reduce our operating expenses will improve our financial performance, or that we will be able to achieve profitability on a quarterly or annual basis in the future. Most of our expenses are fixed in advance. As such, we generally are unable to reduce our expenses significantly in the short-term to compensate for any unexpected delay or decrease in anticipated revenues. As a result, we may continue to experience operating losses and net losses, 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.

We May Need To Raise Additional Capital In The Future, But We May Not Be Able To Secure Adequate Funds On Terms Acceptable To Us, Or At All. We have generated significant net losses and operating losses in recent periods, and have experienced negative cash flows from operations of $2.4 million in the nine months ended December 31, 2003, $4.8 million in the year ended March 31, 2003, $18.2 million in the year ended March 31, 2002 and $20.1 million in the year ended March 31, 2001. Although we completed a private placement in July 2003, the sale of our Anaheim, California property in 2002 and the divestiture of our Zyfer, Broadcast and MAXxess subsidiaries in 2003, the majority of the proceeds from such sales were used to pay our outstanding debts and accounts payables. As of December 31, 2003, our cash balance was approximately $0.3 million. We may need to raise additional capital in the future to fund our operations or to purchase the minority interests in Iteris, Inc. Our Iteris, Inc. subsidiary currently maintains a line of credit with a maximum availability of $5.0 million, which expires in August 2004. Substantially all of the assets of Iteris, Inc. have been pledged to the lender to secure the outstanding indebtedness under this facility ($611,000 was outstanding under the line of credit at December 31, 2003).

We may raise additional capital in the near future, either 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. These conditions, together with our recurring losses and cash requirements, raise substantial doubt about our ability to continue as a going concern.

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

- our ability to control costs;

market acceptance of our products and the overall level of sales of our products;

our ability to generate operating income;

increased research and development funding, and required investments in our Iteris, Inc. subsidiary;

our ability to purchase the minority interests in Iteris, Inc.;

increased sales and marketing expenses;

technological advancements and our competitors' response to our products;

capital improvements to new and existing facilities;

potential acquisitions of businesses and product lines;

our relationships with customers and suppliers; and

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

If our capital requirements are materially different from those currently planned, we may need additional capital sooner than anticipated. If additional funds are raised through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders will be reduced and such securities may have rights, preferences and privileges senior to our common stock. Additional financing may not be available on favorable terms 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 Have Adopted A New Operating Strategy, Which Is Untried And Exposes Us To New Risks. We recently divested ourselves of many of our business units and significantly scaled back our operations in order to focus on the business of our Iteris, Inc. subsidiary. We have abandoned our strategy of incubating emerging companies, which historically required us to make significant investments in new business units. Our current business strategy is narrow and untried, and there is no assurance that our new business strategy or the continued execution of the Iteris, Inc. business will be successful.

The Trading Price Of Our Common Stock Is Highly Volatile And Our Shares Are No Longer Listed On The Nasdaq SmallCap Market. As Such, You May Not Be Able To Resell Your Shares Of Stock At Or Above The Price You Paid For Them Or At All. The trading price of our common stock has been subject to wide fluctuations in the past. Since January 2000, our Class A common stock has traded at prices as low as $0.45 per share and as high as $29.44 per share and our Class B common stock has traded at prices as low as $0.20 per share and as high as $29.62 per share. In 2003, because we failed to meet the minimum stockholder's equity and minimum share price requirements for continued listing on the Nasdaq SmallCap Market, both our Class A common stock and Class B common stock were delisted from the Nasdaq SmallCap Market and currently trade on the OTC Bulletin Board. As such, the average daily trading volume of common stock has decreased, and it may be more difficult for you to sell your shares in the future at or above the price you paid for them, or at all. This delisting may also make it more difficult for us to raise additional funds in the future. In addition, our securities are subject to "penny stock" restrictions, including Rule 15g-9 under the Securities Exchange Act of 1934, as amended, which imposes additional sales practice requirements on broker-dealers, such as requirements pertaining to the suitability of the investment for the purchaser and the delivery of specific disclosure materials and monthly statements. Consequently, the liquidity of our securities could be impaired, not only in the number of securities that can be bought and sold, but also through delays in the timing of the transactions, reduction in security analysts' and the news media's coverage of us, adverse effects on the ability of broker-dealers to sell our securities, and lower prices for our securities than might otherwise be obtained.

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 and improve cash flow;
- our ability to raise additional capital or repurchase the minority interest in Iteris, Inc.;

- shortages announced by suppliers;
- announcements of technological innovations or new products or applications by our competitors, customers or us;
- acquisitions or businesses, products or technologies;
- the impact of any litigation;
- changes in investor perceptions;
- 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 recently experienced volatility, which has particularly affected the market prices of equity securities of many technology companies. This volatility has often been unrelated to the operating performance of these companies. These broad market fluctuations may adversely affect the market price of our common stock. In the past, companies that have experienced volatility in the market price of their securities have been the subject of securities class action litigation. If we were to become the subject of a class action lawsuit, it could result in substantial losses and divert management's attention and resources from other matters.

We Depend On Government Contracts And Subcontracts, And Because Many Of Our Government Contracts Are Fixed Price Contracts, Higher Than Anticipated Costs Will Reduce Our Profit And Could Adversely Impact Our Operating Results. A significant portion of the sales by Iteris, Inc. were derived from contracts with governmental agencies, either as a general contractor, subcontractor or supplier. Government contracts represented approximately 26%, 38% and 47% of our total net sales and contract revenues for the years ended March 31, 2001, 2002 and 2003, respectively. We anticipate that revenue from government contracts will continue to increase in the near future. Government business is, in general, subject to special risks and challenges, including:

- long purchase cycles or approval processes;
- competitive bidding and qualification requirements;
- the impact of international conflicts;
- performance bond requirements;

- changes in government policies and political agendas;
- delays in funding, budgetary constraints and cut-backs; and
- milestone requirements and liquidated damage provisions for failure to meet contract milestones.

In addition, a large number of our government contracts are fixed price contracts. As a result, we may not be able to recover for any cost overruns. 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. These additional costs 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 in any given quarter. Our inability to address any of the foregoing concerns or the loss or renegotiation of any material government contract could seriously harm our business, financial condition and results of operations.

Economic Slowdown And Related Uncertainties Could Adversely Impact The Demand For Our Products. Concerns about inflation, decreased consumer confidence, reduced corporate profits and capital spending, and recent international conflicts and terrorist and military actions have resulted in a downturn in worldwide economic conditions, particularly in the United States. As a result of these unfavorable economic conditions, we have experienced a slowdown in customer orders, cancellations and rescheduling of backlog and higher overhead costs. In addition, recent political and social turmoil related to international conflicts and terrorist acts can be expected to put further pressure on economic conditions in the U.S. and worldwide. These political, social and economic conditions make it extremely difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. If such conditions continue or worsen, our business, financial condition and results of operations will likely be materially and adversely affected.

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:

- our ability to raise additional capital and repurchase the minority interest in Iteris, Inc.;
- our ability to control costs;
- international conflicts and acts of terrorism;
- our ability to develop, introduce, market and gain market acceptance of new products, applications and product enhancements in a timely manner, or at all;
- the size, timing, rescheduling or cancellation of significant customer orders;
- the introduction of new products by competitors;
- the availability of components used in the manufacture of our products;

changes in our pricing policies and the pricing policies by 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;

our success in expanding and implementing our sales and marketing programs;

the effects of technological changes in our target markets;

our relatively small level of backlog at any given time;

the mix of our sales;

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.

In addition, our sales in any quarter may consist of a relatively small number of large customer orders. As a result, the timing of a small number of orders may impact our quarter-to-quarter results. The loss of or a substantial reduction in orders from any significant customer could seriously harm our business, financial condition and results of operations.

Due to all of the factors listed above and, 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.

If We Do Not Keep Pace With Rapid Technological Changes And Evolving Industry Standards, We Will Not Be Able To Remain Competitive And There Will Be No Demand For Our Products. Our markets are in general characterized by the following factors:

rapid technological advances;

downward price pressure in the marketplace as technologies mature;

changes in customer requirements;

frequent new product introductions and enhancements; 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.

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. 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. We cannot assure you that any such investments in research and development will lead to any corresponding increase in revenue.

If We Are Unable To Develop And Introduce New Products And Product Enhancements Successfully And In A Cost-Effective And Timely Manner, Or 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 product costs. 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. Our future success will also depend in part on the success of several products including AutoVue , our lane departure warning system. We currently outsource the manufacture of our AutoVue product line to a single manufacturer. This manufacturer may not be able to produce sufficient quantities of this product in a timely manner or at a reasonable cost, which could materially and adversely affect our ability to launch or gain market acceptance of AutoVue .

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 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. Our business and results of operations could 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.

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 and many smaller regional engineering firms. We expect such competition to increase due to technological advancements, industry consolidations and reduced barriers to entry. Increased competition is likely to result in price reductions, reduced gross margins and loss of market share, any of which could seriously harm our business, financial condition and results of operations. Many of our competitors have far greater name recognition and greater financial, technological, marketing and customer service resources than we do. This may allow them to respond more quickly to new or emerging technologies and changes in customer requirements. It may also allow them to devote greater resources to the development, promotion, sale and support of their products than we can. Recent consolidations of end users, distributors and manufacturers in our target markets have exacerbated this problem. As a result of the foregoing factors, we may not be able to compete effectively in our target markets and competitive pressures could adversely affect our business, financial condition and results of operations.

We May Be Unable To Attract And Retain Key Personnel, Which Could Seriously Harm Our Business. Due to the specialized nature of our business, we are highly dependent on the continued service of our executive officers and other key management, engineering and technical personnel, particularly Joel Slutzky, our Chairman of the Board, who retired in February 2002 as our Chief Executive Officer, Gregory A. Miner, our current Chief Executive Officer and Chief Financial Officer, and Jack Johnson, the Chief Executive Officer of Iteris, Inc. The loss of any of these individuals 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. Competition for 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.

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.

From time to time, we have received notices that claim we have infringed upon the intellectual property of others. Even if these claims are not valid, they could subject us to significant costs. We have engaged in litigation in the past, and 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, both in legal fees and expenses, and the diversion of management's 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 Engage In Acquisitions Of Companies Or Technologies That May Require Us To Undertake Significant Capital Infusions And Could Result In Disruptions Of Our Business And Diversion Of Resources And Management Attention. We have historically, and may in the future, acquire complementary businesses, products and technologies. Acquisitions may require significant capital infusions and, in general, acquisitions also involve a number of special risks, including:

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

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

Our International Business Operations May Be Threatened By Many Factors That Are Outside Of Our Control. Despite the reorganization of our European operations and the resulting reduction in international sales, we continue to engage in international operations. International business operations are also subject to other inherent risks, including, among others:

unexpected changes in regulatory requirements, tariffs and other trade barriers or restrictions;

longer accounts receivable payment cycles;

difficulties in managing and staffing international operations;

potentially adverse tax consequences;

the burdens of compliance with a wide variety of foreign laws and more restrictive labor laws and obligations;

import and export license requirements and restrictions of the United States and each other country in which we operate;

exposure to different legal standards and reduced protection for intellectual property rights in some countries;

currency fluctuations and restrictions; and

political, social and economic instability.

We believe that continued growth and profitability could require expansion of our international operations. Nearly all of our international sales from this point on are denominated in U.S. dollars. As a result, an increase in the relative value of the dollar could make our products more expensive and potentially less price competitive in international markets. We do not engage in any transactions as a hedge against risks of loss due to foreign currency fluctuations.

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

Some Of Our Directors, Officers And Their Affiliates Can Control The Outcome Of Matters That Require The Approval Of Our Stockholders, And Accordingly We Will Not be Able To Engage In Certain Transactions Without Their Approval. As of December 31, 2003, our officers and directors beneficially owned approximately 21% of the total combined voting power of the outstanding shares of our Class A common stock and Class B common stock. As a result of their stock ownership, our management will be able to significantly influence the election of our directors and the outcome of corporate actions requiring stockholder approval, such as mergers and acquisitions, regardless of how our other stockholders may vote. This concentration of voting control may have a significant effect in delaying, deferring or preventing a change in our management or change in control and may adversely affect the voting or other rights of other holders of common stock.

Our Stock Structure And Certain Anti-Takeover Provisions May Affect The Price Of Our Common Stock And Discourage A Third Party From Acquiring Us. Certain provisions of our certificate of incorporation and our stockholder rights plan could make it difficult for a third party to acquire us, even though an acquisition might be beneficial to our stockholders. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. Our Class A common stock entitles the holder to one-tenth of one vote per share and our Class B common stock entitles the holder to one vote per share. The disparity in the voting rights between our common stock, as well as our insiders' significant ownership of the Class B common stock, could discourage a proxy contest or make it more difficult for a third par