ITERIS, INC.
Form 10-Q
July 28, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from to

Commission file number: 001-08762

ITERIS, INC.

(Exact name of registrant as specified in its charter)

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

(949) 270-9400

(Registrant s telephone number, including area code)

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

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

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

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

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

As of July 23, 2010, there were 34,331,756 shares of common stock outstanding.

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ITERIS, INC.

Quarterly Report on Form 10-Q
For the Three Months Ended June 30, 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.

AutoVue®, Iteris®, Vantage®, VantageView , VersiCam , SafetyDirect and Abacus are among the trademarks of Iteris, Inc. Any other trademarks or trade names mentioned herein are the property of their respective owners.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Iteris, Inc.

Unaudited Condensed Consolidated Balance Sheets

(In thousands, except par value)

	June 30, 2010	March 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 11,676	$ 10,405
Trade accounts receivable	11,599	11,311
Costs in excess of billings on uncompleted contracts	4,176	3,871
Inventories	3,043	2,727
Deferred income taxes	4,526	4,993
Prepaid expenses and other current assets	686	623
Total current assets	35,706	33,930
Property and equipment, net	2,407	2,550
Deferred income taxes	9,739	9,739
Intangible assets, net	416	452
Goodwill	27,791	27,791
Other assets	215	200
Total assets	$ 76,274	$ 74,662
Liabilities and stockholders equity		
Current liabilities:		
Trade accounts payable	$ 3,285	$ 2,492
Accrued payroll and related expenses	3,173	2,709
Accrued liabilities	1,758	1,748
Billings in excess of costs and estimated earnings on uncompleted contracts	2,190	2,105
Current portion of long-term debt	2,324	2,324
Total current liabilities	12,730	11,378
Deferred rent	1,308	1,386
Unrecognized tax benefits	751	751
Other non-current liabilities		112
Long-term debt	2,512	2,969
Total liabilities	17,301	16,596
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 June 30, 2010 and March 31, 2010, respectively	3,433	3,432
Additional paid-in capital	137,612	137,503
Accumulated deficit	(82,072)	(82,869)
Total stockholders equity	58,973	58,066
Total liabilities and stockholders equity	$ 76,274	$ 74,662

See accompanying notes.

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Iteris, Inc.

Unaudited Condensed Consolidated Statements of Income

(In thousands, except per share amounts)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
Net sales and contract revenues:		
Net sales	$ 9,462	$ 6,933
Contract revenues	6,212	7,701
Total net sales and contract revenues	15,674	14,634
Costs of net sales and contract revenues:		
Cost of net sales	4,520	3,843
Cost of contract revenues	4,137	5,209
Gross profit	7,017	5,582
Operating expenses:		
Selling, general and administrative	4,641	4,253
Research and development	941	964
Amortization of intangible assets	36	44
Total operating expenses	5,618	5,261
Operating income	1,399	321
Non-operating income (expense):		
Other income, net	1	19
Interest expense, net	(40)	(86)
Income before income taxes	1,360	254
Provision for income taxes	(563)	(110)
Net income	$ 797	$ 144
Earnings per share:		
Basic	$ 0.02	$ 0.00
Diluted	$ 0.02	$ 0.00
Weighted-average shares outstanding:		
Basic	34,329	34,192
Diluted	34,692	34,386

See accompanying notes.

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Iteris, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(In thousands)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
Cash flows from operating activities		
Net income	$ 797	$ 144
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in deferred tax assets	467	
Depreciation of property and equipment	244	256
Stock-based compensation	91	89
Amortization of intangible assets	36	44
Changes in operating assets and liabilities:		
Accounts receivable	(288)	644
Net costs and estimated earnings in excess of billings	(220)	159
Inventories	(316)	503
Prepaid expenses and other assets	(78)	(128)
Accounts payable and accrued expenses	1,183	(1,690)
Net cash provided by operating activities	1,916	21
Cash flows from investing activities		
Purchases of property and equipment	(101)	(42)
Cash paid for business combination	(106)	(300)
Net cash used in investing activities	(207)	(342)
Cash flows from financing activities		
Borrowings on long-term debt		750
Payments on long-term debt	(457)	(889)
Proceeds from stock option exercises	19	72
Net cash used in financing activities	(438)	(67)
Effect of exchange rate changes on cash		34
Increase (decrease) in cash and cash equivalents	1,271	(354)
Cash and cash equivalents at beginning of period	10,405	6,372
Cash and cash equivalents at end of period	$ 11,676	$ 6,018
Supplemental disclosure of non-cash investing and financing activities:		
Liabilities incurred for business combination	$	$ 218

See accompanying notes.

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Iteris, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2010

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Iteris, Inc. (including our subsidiary, referred to collectively in these consolidated financial statements as Iteris, the Company, we, our and us a leader in the traffic management market focused on the development and application of advanced technologies that reduce traffic congestion 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 imact 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 June 30, 2010, the consolidated results of operations for the three months ended June 30, 2010 and 2009 and the consolidated cash flows for the three months ended June 30, 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 months ended June 30, 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 price.

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

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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 income and totaled $141,000 and $248,000 for the three months ended June 30, 2010 and 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, net in the unaudited consolidated statements of income.

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 historically been within management s expectations.

Fair Values of Financial Instruments

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

Cash and Cash Equivalents

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

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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 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 will 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.

We also evaluate long-lived assets for impairment which requires impairment evaluation on long-lived assets used in operations 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.

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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 income 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.

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 income.

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.

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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.

2. Supplemental Financial Information

Inventories

The following table presents details of our inventories:

	June 30, 2010	March 31, 2010
	(In thousands)	
Materials and supplies	$ 2,443	$ 2,292
Work in process	72	49
Finished goods	528	386
	$ 3,043	$ 2,727

Intangible Assets

The following table presents details of our intangible assets:

	June 30, 2010		March 31, 2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
		(In thousands)		
Intangible assets subject to amortization:				
Developed technology	$ 996	$ (620)	$ 996	$ (595)
Patents	317	(277)	317	(266)
Total	$ 1,313	$ (897)	$ 1,313	$ (861)

As of June 30, 2010, future estimated amortization expense is as follows:

Year Ending March 31:

(In thousands)		
Remainder of 2011	$	110
2012		106
2013		100
2014		100
	$	416

Warranty Reserve Activity

The following table presents activity related to the warranty reserve:

	Three Months Ended June 30,			
	2010		2009	
	(In thousands)			
Balance at beginning of period	$	468	$	582
Additions charged to cost of sales		38		52
Warranty claims		(30)		(51)
Balance at end of period	$	476	$	583

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Earnings Per Share

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

	Three Months Ended June 30, 2010	2009
	(In thousands, except per share amounts)	
Numerator:		
Net Income	$ 797	$ 144
Denominator:		
Weighted average common shares used in basic computation	34,329	34,192
Dilutive stock options	360	194
Dilutive warrants	3	
Weighted average common shares used in diluted computation	34,692	34,386
Earnings per share:		
Basic	$ 0.02	$ 0.00
Diluted	$ 0.02	$ 0.00

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

	Three Months Ended June 30, 2010	2009
	(Shares in thousands)	
Stock options	860	2,583
Warrants	321	491

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 for which little or no market data exists, therefore requiring an entity to develop its own assumptions.

At June 30, 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. No non-financial assets were measured at fair value during the three months ended June 30, 2010 and 2009.

4. Revolving Line of Credit and Long-Term Debt

Revolving Line of Credit

In October 2008, we entered into a $19.5 million credit facility with California Bank & Trust, which provides for a two-year revolving line of credit with borrowings of up to $12.0 million and a $7.5 million 48-month term note (discussed below). Interest on borrowed amounts under the revolving line of credit are payable monthly at a rate equal to the current stated prime rate (3.25% at June 30, 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 June 30, 2010, no amounts were outstanding under the revolving line of credit portion of the facility.

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Long-Term Debt Bank Term Note

Under our current credit facility, we may borrow up to $7.5 million in the form of a 48-month term note. As of June 30, 2010, we had outstanding borrowings of approximately $4.8 million under this term note. Principal payments under this term note are required to be repaid in 48 monthly installments of $152,000 commencing on June 1, 2009. Additionally, beginning on November 1, 2009, and on November 1 of each year thereafter, we are required to repay additional principal of up to $500,000, calculated based on certain financial measures, as further defined in the agreement. These additional principal payments effectively reduce the total number of monthly installments necessary to repay the term note. As of June 30, 2010 and March 31, 2010, an additional $500,000 was included in the current portion of the term note, representing the amount we estimate will be due on November 1, 2010. Interest on the term note is payable monthly at a rate equal to the current stated prime rate plus 0.50% up to the current stated prime rate plus 1.00%, depending on aggregate deposit balances maintained at the bank in relation to the total loan commitment under the credit facility. The term note contains no early termination fees and, along with the revolving line of credit under the same credit agreement, is secured by substantially all of our assets.

5. Income Taxes

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

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
	(In thousands)	
Provision for income taxes	$ 563	$ 110
Effective tax rate	41.4%	43.3%

On an interim basis, we estimate what our anticipated annual effective tax rate will be, while also separately considering applicable discrete and other non-recurring items, and record a quarterly income tax provision in accordance with the anticipated annual rate. As the fiscal year progresses, we refine our estimates based on actual events and financial results during the year. This process can result in significant changes to our expected effective tax rate. When this occurs, we adjust our income tax provision during the quarter in which our estimates are refined so that the year-to-date provision reflects the expected annual effective tax rate. These changes, along with adjustments to our deferred taxes, among others, may create fluctuations in our overall effective tax rate from quarter to quarter.

6. Commitments and Contingencies

Litigation and Other Contingencies

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

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

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. MAXxess is owned by an investor group that includes two of our directors. As of June 30, 2010, all accrued interest has been paid and the entire $274,000 principal balance was outstanding and payable to Iteris and remains fully reserved.

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7. Stockholders Equity

Stock-Based Compensation

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

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
	(In thousands)	
Cost of net sales	$ 2	$ 2
Cost of contract revenues	8	10
Selling, general and administrative expense	74	71
Research and development expense	7	6
	$ 91	$ 89

At June 30, 2010, there was approximately $727,000 of total unrecognized compensation expense related to unvested stock options. This expense is expected to be recognized over a weighted average period of approximately 2.6 years. If there are any modifications or cancellations of the underlying unvested stock options, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that we issue additional stock options or other stock-based awards.

Stock Options

A summary of activity in our stock option plans for the three months ended June 30, 2010 is as follows:

	Number of	Weighted-Average