

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended March 31, 2003

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

ODETICS, 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.)

1515 South Manchester Avenue, Anaheim, California 92802
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: **(714) 774-5000**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Class A common stock, \$.10 par value
Class B common stock, \$.10 par value
(Title of Class)

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

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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

Based on the closing sale price on Nasdaq SmallCap Market on September 30, 2002, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting stock held by nonaffiliates of the registrant was \$10,081,109. For the purposes of this calculation, shares owned by officers, directors and 10% stockholders known to the registrant have been deemed to be owned by affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Odetics has two classes of common stock outstanding, the Class A common stock and the Class B common stock. The rights, preferences and privileges of each class of common stock are identical in all respects, except for voting rights. Each share of Class A common

stock entitles its holder to one-tenth of one vote per share and each share of Class B common stock entitles its holder to one vote per share. As of June 27, 2003, there were 14,112,823 shares of Class A common stock and 1,003,932 shares of Class B common stock outstanding. Unless otherwise indicated, all references to common stock collectively refer to the Class A common stock and the Class B common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates by reference certain information from the registrant's definitive proxy statement for its Annual Meeting of Stockholders, which is expected to be held on August 28, 2003. Except with respect to the information specifically incorporated by reference in this report, the proxy statement is not deemed to be filed as a part of this report.

ODETICS, INC.

FORM 10-K ANNUAL REPORT

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In this report, "Odetics," the "Company," the "Registrant," "we," "us" and "our" collectively refers to Odetics, Inc. and its subsidiaries.

PART I

ITEM 1. BUSINESS.

Overview

Odetics, Inc. provides products, systems and services that control and manage the use of public roadways and secure access and safety of public and private facilities. Our company was founded in 1969 to supply digital recorders for use in the United States space program. We broadened our information automation product line to include time-lapse videocassette recorders for commercial security and surveillance applications through our Gyr division, which was subsequently incorporated to form our Gyr Incorporated subsidiary. We formed our Zyfer, Inc. subsidiary to develop and manufacture timing and synchronization products for telecommunication networks. Timing and synchronization products are devices that contain both hardware and software to synchronize the data streams in telecommunications networks and are used to increase the reliability and operability of such networks.

In the early 1980s, we established our Odetics Broadcast division, which we later incorporated as Broadcast, Inc. Broadcast developed and supplied software-based systems that integrated, controlled and automated the management of multiple classes of equipment used in the operation of a broadcast studio and satellite uplink facility in the television, cable and satellite industries.

Leveraging our expertise in video image processing, we entered into the intelligent transportation systems ("ITS") business with the introduction of a video-based vehicle detection system in 1993. 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 June 30, 2003, Odetics owned 74.5% of the outstanding common stock of Iteris and 59.1% of the common stock assuming full conversion of the outstanding Series A preferred stock of Iteris. We currently operate Meyer, Mohaddes Associates, Inc. as a wholly-owned subsidiary of Iteris.

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 to be our core businesses, Iteris, Inc. and MAXxess Systems, Inc. In September 2001, we sold the assets of our Gyr Closed Circuit Television ("CCTV") 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 Gyr subsidiary to MAXxess Systems, Inc., which currently designs and manufactures security management systems that feature a broad array of detection, monitoring and management capabilities for both governmental and commercial customers.

In March 2003, we decided to cease the development and sale of any new Broadcast products and to sell Zyfer. As a result, we reduced our Broadcast organization to only support existing customer contracts for service and support through their expiration dates. In May 2003, we sold substantially all of the assets of Zyfer.

After giving effect to our divestitures and narrowed focus mentioned above, we currently operate in only two business segments: ITS and Security Products. Our ITS segment consists of Iteris, our 59.11% owned subsidiary, and our Security Products segment consists of MAXxess, Inc., our wholly-owned subsidiary.

Iteris, Inc.

Iteris, Inc. designs, develops, markets and implements sensors and systems for surface transportation. Using its proprietary software and ITS industry expertise, Iteris provides video sensor systems and transportation management and traveler information systems for the ITS industry. The ITS industry is comprised of companies applying a variety of technologies to enable the safe and efficient movement of people and goods. Iteris uses its outdoor image recognition software expertise to develop proprietary algorithms for video sensor systems that improve vehicle safety and the flow of traffic. Using its knowledge of the ITS industry, Iteris designs and implements transportation management systems that help public agencies reduce traffic congestion and provide greater access to traveler information.

Iteris' proprietary image recognition systems include AutoVue™ and Vantage™. AutoVue is a small windshield mounted sensor that uses proprietary software to detect and warn drivers of unintended lane departures. Iteris has approximately 3,000 production AutoVue units that are in use on truck platforms in the European market and are offered as an option on certain Actros trucks, which are part of the Daimler group. Iteris believes that AutoVue is a broad sensor platform that, through additional software development, may be expanded to incorporate additional safety and convenience features. Vantage is a video vehicle sensing system that detects the presence of vehicles at signalized intersections enabling a more efficient allocation of green signal time.

Iteris' transportation management systems includes the design, development and implementation of its 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 and other engineering for the implementation of transportation related communications systems, analysis and study related to goods movement and commercial vehicle operations, and parking systems designs.

Sales, Marketing and Principal Customers. Iteris markets and sells its transportation management systems and services directly to government agencies pursuant to negotiated contracts that involve competitive bidding and specific qualification requirements. Most of our contracts with federal, state, and municipal customers provide for cancellation or renegotiation at the option of the customer upon reasonable notice and fees paid for modification. We use selected members of our engineering team divided on a regional basis to serve in sales and business development functions. We do not engage in international ITS sales. Sales of Iteris' systems contracts generally involve long lead times and require extensive specification development, evaluation and price negotiations. No single customer of Iteris accounted for more than 10% of our total net sales and contract revenues.

Iteris sells its Vantage vehicle detection systems primarily through indirect sales channels comprised of independent dealers in the United States and Canada who sell integrated systems and related products to the traffic intersection market. The independent dealers for Iteris are primarily responsible for sales, installation and support of Vantage systems. These dealers maintain an inventory of demonstration traffic products including the Vantage vehicle detection systems and sell directly to government agencies and installation contractors. These dealers often have long-term arrangements with the government agencies in their territory for the supply of various products for the construction and renovation of traffic intersections. Iteris holds technical training classes for its dealers and maintains a full-time staff of customer support technicians to provide technical assistance when needed.

The marketing strategy for AutoVue is to establish it as the leading platform for in vehicle video sensing for trucks and passenger cars. AutoVue is sold directly by Iteris to vehicle manufacturers and major automotive suppliers. Iteris also markets to the manufacturers of automobiles through a strategic relationship with Valeo.

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Manufacturing and Materials. Iteris uses local manufacturers based near our Anaheim facility to build subassemblies that are used in its Vantage products. These subassemblies are delivered to our Anaheim facility where they go through a final assembly and test prior to the shipment to our customers. Iteris' manufacturing activities are conducted in approximately 6,000 square feet of space at our Anaheim facility. Most subassemblies used in our products are manufactured by subcontractors who are local to our Anaheim, California facilities. Certain of our cameras used in our products have historically been provided by a Japanese supplier who is sole sourced; however, we are currently qualifying other sources of supply. Production volume is based upon quarterly forecasts that Iteris readjusts on a monthly basis to control inventory. Iteris subcontracts the manufacture of its AutoVue systems to one manufacturer, and our internal processes are limited primarily to testing and final verification. Iteris currently does not manufacture any of the hardware used in the transportation management and traveler information systems that it designs and implements. The production facility for Iteris is currently ISO 9001 certified.

Customer Support and Services. We provide warranty service for each of our products, as well as follow-up service and support, for which we typically charge separately. We view customer support services as a critical competitive factor as well as a revenue source.

MAXxess Systems, Inc.

MAXxess Systems, Inc. designs, develops and manufactures security management systems that include detection, monitoring and management capabilities for both governmental and commercial customers. MAXxess offers software, hardware and other technologies for creating and using electronic access control products such as identification and access badges that are based on smart cards and other electronic devices. These products are principally used to control and manage physical access to facilities. We also provide software-based systems and hardware used for detection and response of management to dangerous chemicals and gases in and around facilities.

During fiscal 2003, we introduced our Environmental Security Systems, which integrate our legacy AXxess 202 product family with new detection technologies for toxic chemicals and gases. During fiscal 2003, MAXxess further extended its Environmental Security Systems offering by introducing its Safe Cities™ System, which is a software-based management system for use by municipal customers that integrates disparate information and detection infrastructure within a city in order to provide rapid response for emergency management against threats of terrorism and weapons of mass destruction. MAXxess believes that its Environmental Security Systems provide enhanced levels of monitoring, control and detection that will be required across a broad cross section of municipal infrastructure and in various public facilities including buildings, airports, ports and other potential targets of terrorism.

Sales, Marketing and Principal Customers. MAXxess generally markets and sells its products globally through a network of system integrators, in addition to selling direct to municipal customers. In the United States, MAXxess has three regional sales managers who oversee three geographical regions and manage the systems integrators. MAXxess operates a full service branch office in Bracknell Berkshire U.K., which serves the sales needs of the European, Middle East and Asian regions. The Bracknell office also provides local product availability and technical support for the region. MAXxess has also partnered with Draeger Safety of Lubeck, Germany, to market its chemical detectors principally to governmental customers. These chemical detectors are primarily focused on the Immune Building Program, which is sponsored by Defense Advanced Research Projects Agency ("DARPA"). No single customer of MAXxess represented more than 10% of our total net sales and contract revenues for fiscal 2003.

Manufacturing and Materials. Similar to Iteris, MAXxess uses local manufacturers based near our Anaheim manufacturing facility to build subassemblies that are used in our final products. These subassemblies and other components are delivered to our Anaheim manufacturing facility where they

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go through a final assembly and test prior to shipment to its customers. MAXxess builds inventory according to our sales forecasts. MAXxess maintains a dedicated manufacturing area of approximately 2,500 square feet located within our Anaheim facilities. MAXxess maintains infrastructure to support production and inventory control, purchasing, quality assurance and manufacturing engineering. Although we consolidate our materials sourcing and subcontract manufacturing to minimize production costs. We believe that each of our sources are capable of being substituted for minimal cost and production delay. There are currently no sole sourced raw materials used in our products.

Customer Support and Services. We provide warranty service and support for each of our products and follow-up service and support, for which we charge separately. Service revenue accounts for less than 5% of total net sales and contract revenues. Customer support is a critical competitive factor. We provide warranty and customer service internationally from our Bracknell Berkshire offices.

Backlog

Our backlog of unfulfilled firm orders was approximately \$24.0 million as of March 31, 2003 and was approximately \$42.7 million as of March 31, 2002. Approximately 67% of our backlog at March 31, 2002 was recognized as revenues in the fiscal year ended March 31, 2003, and approximately 87% of our backlog at March 31, 2003 is expected to be recognized as revenues in the fiscal year ended March 31, 2004. Pursuant to the customary terms of our agreements with government contractors and other customers, customers can generally cancel or reschedule orders with little or no penalties. Lead times for the release of purchase orders depend upon the scheduling and forecasting practices of our individual customers, which also can affect the timing of the conversion of our backlog into revenues. For these reasons, among others, our backlog at a particular date may not be indicative of our future revenues.

Product Development

MAXxess and Iteris each direct and staff its own product development activities. Most of our development activities are conducted at our principal facilities in Anaheim, California. Our company-sponsored research and development costs and expenses were approximately \$7.5 million in fiscal 2001, \$4.4 million in fiscal 2002 and \$4.2 million in fiscal 2003. Although spending for product development declined sharply in fiscal 2002 compared to fiscal 2001, principally due to the discontinuation of development activities related to personalized traveler information products in Iteris and the sale of Gyrr's CCTV Products line, we expect to continue to pursue significant product development programs and incur significant research and development expenditures in each of our business units.

Competition

Our business units generally face significant competition in each of their respective markets. Increased competition may result in price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on our business, financial condition and results of operations.

MAXxess principally competes with Casi-Rusco, Cardkey, Lenel and Northern Computers in the sale of access control systems. The market for electronic access control products is highly fragmented, We estimate that there are approximately 100 competitors comprising approximately \$800 million in annual sales. MAXxess is substantially smaller in terms of annual revenue than its leading competitors. In the area of chemical and gas detection, MAXxess primarily competes with Smiths Detection. MAXxess is a smaller company in terms of annual revenue than Smiths Detection, but MAXxess does not believe there is any direct competitor for its Safe Cities system. MAXxess generally competes on the basis of its distributed processing system architecture, which is an open system that readily integrates other security subsystems and new detection capabilities, and a superior operator interface.

We believe that AutoVue is the only commercially-available lane departure warning system used in the U.S. and in Europe, potential competitors of AutoVue include Delphi Automotive Systems Corporation domestically, NEC Corporation and Hitachi Ltd. in Japan and Robert Bosch GmbH in Europe, which we suspect are currently developing video sensor technologies for the vehicle industry that could be used for lane departure warning systems. In the market for our Vantage vehicle detection systems, Iteris competes with manufacturers of other "above ground" video camera detection systems such as Econolite Control Products, Inc., Trafficon, N.V. Peek Traffic Systems, and other non-intrusive detection devices including microwave, infrared, ultrasonic and magnetic detectors, as well as manufacturers and installers of in-pavement inductive loop products. Our competitors for Vantage products do not disclose specific sales numbers, either because they are private companies or because they are part of larger companies. Based on our interface with them in the market, we believe that we are leading our competitors in annual sales volume for video detection products.

The transportation management and traveler information systems market is highly fragmented and is subject to evolving national and regional quality and safety standards. Iteris' competitors vary in number, scope and breadth of the products and services they offer. Iteris' competitors in advanced transportation management and traveler information systems include large multi-national corporations such as Transcore, Lockheed Martin Corporation, PB Farradyne Inc., Kimley-Horn and Associates, Inc. and National Engineering Technology, Inc. Iteris' competitors in transportation engineering, planning and design include major firms such as Parsons Brinkerhoff, Inc. and Parsons Transportation Group Inc., as well as many smaller regional engineering firms. We believe that the transportation management and traveler information systems business of Iteris is one of the leading competitors in the ITS market.

In general, the markets for the products and services offered by our businesses are highly competitive and are characterized by rapidly changing technology and evolving standards. Many of our current and prospective competitors have longer operating histories, greater name

recognition, access to larger customer bases and significantly greater financial, technical, manufacturing, distribution and marketing resources than us. As a result, they may be able to adapt more quickly to new or emerging standards or technologies or to devote greater resources to the promotion and sale of their products. It is also possible that new competitors or alliances among competitors could emerge and rapidly acquire significant market share. We believe that our ability to compete effectively in our target markets will depend on a number of factors, including the success and timing of our new product development, the compatibility of our products with a broad range of computing systems, product quality and performance, reliability, functionality, price, and service and technical support. Our failure to provide services and develop and market products that compete successfully with those of other suppliers and consultants in our target markets would have a material adverse effect on our business, financial condition and results of operations.

Intellectual Property and Proprietary Rights

Our ability to compete effectively depends in part on our ability to develop and maintain the proprietary aspects of our technology. Our policy is to obtain appropriate proprietary rights protection for any potentially significant new technology acquired or developed each of our business units. Iteris currently holds six U.S. patents, which expire commencing in 2012, and has eighteen U.S. patent applications pending, mostly relating to our outdoor image processing techniques used in our AutoVue and Vantage systems. Two of our patents relate specifically to our AutoVue technology and provide a basis for enhanced functionality for rain sensing and improved performance. We believe that our other patents, while important for our technology platform, are less critical to near term product strategy. We cannot assure you that any new patents will be granted pursuant to any outstanding or subsequent applications.

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We own a patent and have three patents pending for StealthKey technology, which technology is not currently part of our product family. Our intention is to pursue product development for a high-speed security processor designed around the StealthKey patent.

In addition to patent laws, we rely on copyright and trade secret laws to protect our proprietary rights. We attempt to protect our trade secrets and other proprietary information through agreements with customers and suppliers, proprietary information agreements with our employees and consultants, and other similar measures. Iteris does not have any material licenses or trademarks other than those relating to product names. We cannot be certain that we will be successful in protecting our proprietary rights. While we believe our patents, patent applications, software and other proprietary know-how have value, changing technology makes our future success dependent principally upon our employees' technical competence and creative skills for continuing innovation.

Litigation has been necessary in the past and may be necessary in the future to enforce our proprietary rights, to determine the validity and scope of the proprietary rights of others, or to defend us against claims of infringement or invalidity by others. An adverse outcome in such litigation or similar proceedings could subject us to significant liabilities to third parties, require disputed rights to be licensed from others or require us to cease marketing or using certain products, any of which could have a material adverse effect on our business, financial condition and results of operations. In addition, the cost of addressing any intellectual property litigation claim, both in legal fees and expenses, as well as from the diversion of management's resources, regardless of whether the claim is valid, could be significant and could have a material adverse effect on our business, financial condition and results of operations.

Employees

We refer to our employees as associates. As of June 12, 2003, Odetics and its subsidiaries employed an aggregate of 253 associates, including 70 associates in general management, administration and finance; 17 associates in sales and marketing; 119 associates in product development; 35 associates in operations, manufacturing and quality; and 12 associates in customer service. None of our associates are represented by a labor union, and we have never experienced a work stoppage.

Government Regulation

Our manufacturing operations are subject to various federal, state and local laws and regulations, including those restricting the discharge of materials into the environment. We are not involved in any pending or, to our knowledge, threatened governmental proceedings, which would require curtailment of our operations because of such laws and regulations. We continue to expend funds in connection with our compliance with applicable environmental regulations. These expenditures have not, however, been significant in the past, and we do not expect any significant expenditure in the near future. Currently, compliance with foreign laws has not had a material impact on our business and is not expected to have a material impact in the near future. Subsequent to the downsizing and reorganization of our foreign operations, our only international operations are for MAXxess Ltd, a U.K., based subsidiary of our MAXxess Inc. subsidiary in the United States.

ITEM 2. PROPERTIES.

Our headquarters and principal operations consist of leased facilities located in Southern California and consist of a two building complex containing approximately 257,900 square feet situated on approximately 14 acres located at 1515 and 1585 South Manchester Boulevard in Anaheim, California. These facilities house our administrative offices (approximately 20,000 dedicated square feet), as well as the operations of MAXxess, (approximately 10,000 dedicated square feet), and Iteris (approximately 55,000 dedicated square feet). In addition, FEI-Zyfer, the acquirer of substantially all of

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the assets of our subsidiary Zyfer, Inc., subleases 20,000 dedicated square feet in our 1585 South Manchester facility under a two year sublease. As of March 31, 2003, as a result of substantial downsizing and divestitures or shutdowns of our Broadcast, Gyr, and Mariner Networks subsidiaries over the prior two fiscal years, we have approximately 140,000 square feet of idle capacity.

In May 2002, we completed the sale and leaseback of our Anaheim facilities for an aggregate sales price of \$22.6 million. We entered into a 30-month lease for 1585 South Manchester for a monthly rental payments of \$57,553, and a ten-year lease for 1515 South Manchester for a monthly rental payment of \$152,150. Iteris is a sublessee to Odetics for 55,000 square feet under similar terms to the master lease between Odetics and the master lessor. We are currently in negotiations with the landlord for our Anaheim facilities to reduce our overall operating expenses to a level commensurate with our existing operations. We cannot assure you that we will be able to complete these negotiations successfully.

We also lease approximately 7,400 square feet in Austin, Texas. Subsequent to the discontinuance of Broadcast, we operate a service organization in support of Broadcast customers in this facility. Iteris leases twelve office suites representing an aggregate of approximately 20,000 square feet within the United States for its support staff and development teams.

We currently operate a single shift in each of our manufacturing and assembly facilities, and we believe that our facilities are adequate for our needs for at least the next twelve months.

ITEM 3. LEGAL PROCEEDINGS.

We are not currently a party to any material legal proceedings.

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

No matters were submitted to a vote of our security holders during the three months ended March 31, 2003.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Since April 22, 2002, our Class A common stock and Class B common stock has been listed on the Nasdaq SmallCap Market under the symbols "ODETA" and "ODETB," respectively. Our Class B common stock was delisted from the Nasdaq SmallCap Market in April 2003 and is currently quoted on the OTC Bulletin Board. Prior to April 22, 2002, our Class A common stock and Class B common stock were listed on the Nasdaq National Market. The following table sets forth the fiscal periods indicated the high and low sales prices for the Class A common stock and Class B common stock as reported by the Nasdaq SmallCap Market.

	Class A Common Stock		Class B Common Stock	
	High	Low	High	Low
Fiscal 2002				
Quarter Ended June 30, 2001	\$ 4.60	\$ 1.88	\$ 4.64	\$ 2.95
Quarter Ended September 30, 2001	2.49	1.24	3.80	1.37
Quarter Ended December 31, 2001	2.10	1.05	2.58	1.35
Quarter Ended March 31, 2002	1.95	1.34	3.75	1.82
Fiscal 2003				
Quarter Ended June 30, 2002	1.70	1.27	2.57	1.85
Quarter Ended September 30, 2002	1.52	.85	2.00	1.00
Quarter Ended December 31, 2002	1.03	.45	1.00	.42
Quarter Ended March 31, 2003	.74	.51	.75	.52
Fiscal 2004				
Quarter Ending June 30, 2003 (through June 27, 2003)	.89	.45	.53	.20

As of June 27, 2003, we had 509 holders of record of Class A common stock and 105 holders of record of Class B common stock according to information furnished by our transfer agent.

Dividend Policy

We have never paid or declared cash dividends on either class of our common stock, and have no current plans to pay such dividends in the foreseeable future. We currently intend to retain any earnings for working capital and general corporate purposes. The payment of any

future dividends will be at the discretion of our Board of Directors, and will depend upon a number of factors, including, but not limited to, future earnings, the success of our business, activities, our capital requirements, our general financial condition and future prospects, general business conditions, the consent of our lender and such other factors as the Board may deem relevant.

Recent Sales of Unregistered Securities

During the quarter ended March 31, 2003, we did not sell or issue any unregistered securities.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA.

The following selected consolidated financial data with respect to our consolidated statement of operations for each of the five fiscal years in the period ended March 31, 2003 and the consolidated balance sheet data at March 31, 1999, 2000, 2001, 2002 and 2003 are derived from our audited consolidated financial statements. The consolidated statements of operation data for the fiscal years ended March 31, 1999 and 2000 and the consolidated balance sheet data at March 31, 1999, 2000 and 2001 are not included in the consolidated financial statements included elsewhere in this report. The following information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and with our consolidated financial statements and the related notes thereto included elsewhere in this report.

	Fiscal Year Ended March 31,				
	1999	2000	2001	2002	2003
	(in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Net sales	\$ 45,291	\$ 44,467	\$ 42,363	\$ 29,343	\$ 22,541
Contract revenues	13,331	18,666	20,039	22,846	25,086
Total net sales and contract revenues	58,622	63,133	62,402	52,189	47,627
Costs and expenses:					
Cost of net sales	32,245	33,455	31,028	16,769	11,424
Cost of contract revenues	9,007	13,431	13,781	13,132	16,034
Selling, general and administrative expenses	20,119	25,177	25,219	18,491	16,157
Research and development expenses	6,566	6,558	7,549	4,385	4,215
Restructuring charges	—	—	757	2,189	—
Total costs and expenses	67,927	78,621	78,334	54,966	47,830
Loss from operations	(9,315)	(15,488)	(15,932)	(2,777)	(203)
Non-operating income (expense):					
Royalty income	—	38,437	17,825	—	—
Other income, net	228	—	1,340	2,919	388
Interest expense, net	(1,807)	(2,048)	(1,762)	(4,190)	(761)
Income (loss) before income tax	(10,894)	21,007	1,471	(4,048)	(576)
Income tax benefit	—	—	—	785	—
Income (loss) from continuing operations before minority interest	(10,894)	21,007	1,471	(3,263)	(576)
Minority interest in earnings of subsidiary	—	—	—	(1,910)	(3,818)
Income (loss) from continuing operations	(10,894)	21,007	1,471	(5,173)	(4,394)
Loss from discontinued operations, net of income tax	(9,224)	(23,286)	(34,011)	(20,965)	(8,754)
Extraordinary loss from early extinguishment debt, net of tax of \$0	—	—	—	(450)	—
Net loss	\$ (20,118)	\$ (2,279)	\$ (32,540)	\$ (26,588)	\$ (13,148)
Basic earnings (loss) per share:					
Continuing operations	\$ (1.39)	\$ 2.31	\$ 0.15	\$ (0.46)	\$ (0.31)
Discontinued operations	(1.18)	(2.56)	(3.41)	(1.86)	(0.61)
Extraordinary loss	—	—	—	(0.04)	—
Basic net loss per share	\$ (2.57)	\$ (0.25)	\$ (3.26)	\$ (2.36)	\$ (0.92)
Diluted earnings (loss) per share:					
Continuing operations	\$ (1.39)	\$ 2.22	\$ 0.14	\$ (0.46)	\$ (0.31)

Discontinued operations	\$ (1.18)	(2.47)	(3.33)	(1.86)	(0.61)
Extraordinary loss	—	—	—	(0.04)	—
Diluted net loss per share	\$ (2.57)	\$ (0.24)	\$ (3.19)	\$ (2.36)	\$ (0.92)
Shares used in calculating basic earnings (loss) per share	7,820	9,089	9,977	11,267	14,276
Shares used in calculating diluted earnings (loss) per share	7,820	9,444	10,209	11,267	14,276

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	At March 31,				
	1999	2000	2001	2002	2003
	(in thousands)				
Consolidated Balance Sheet Data:					
Working capital (deficit)	\$ 26,066	\$ 22,283	\$ (3,704)	\$ (7,604)	\$ 3,345
Total assets	81,355	81,850	68,061	52,238	34,842
Long-term debt (less current portion)	19,962	11,666	4,800	2,042	1,265
Accumulated deficit	(23,913)	(26,192)	(58,732)	(85,320)	(98,468)
Total stockholders' equity (deficit)	36,323	36,110	20,378	5,255	(4,288)

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

Cautionary Statement

This report including the following discussion and analysis contains forward-looking statements 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)," "estimates" 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 revenue, expenses, capital needs, competition, backlog and manufacturing capabilities 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 which could cause 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 undertake no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. 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 at the end of Part II, Item 7 of this report and in "Management's Discussion and Analysis of Financial Condition and Results of Operations" below 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.

General

During the fiscal year ended March 31, 2003 ("fiscal 2003"), we operated in three business segments consisting of ITS, video products and telecom products. The ITS segment consisted of our majority-owned subsidiary, Iteris, Inc., which designs, develops, markets and implements video sensor systems and transportation management and traveler information systems for the ITS industry. The video products segment consisted of our wholly-owned subsidiaries, MAXxess Systems, Inc. (previously known as Gyyr Incorporated) and Broadcast, Inc. Our telecom segment consisted of our wholly-owned subsidiary, Zyfer, Inc., which prior to its incorporation was operated as our Communications division. All references to our subsidiaries in this report include the prior business and results of operations of such subsidiaries as our business units prior to their incorporation.

In April 2001, we bifurcated Gyyr's operations into the Gyyr CCTV Products line, which manufactured analog and digital storage systems, and the Gyyr Electronic Access Control division, which develops and manufactures enterprise security management systems for facility security and trace detection of dangerous chemicals. In September 2001, we sold substantially all of the assets and certain liabilities of the Gyyr CCTV Products line for \$8.8 million. In connection with this sale, we changed the name of Gyyr to MAXxess Systems, Inc. to reflect the focus of this business on electronic access control systems.

Broadcast provided software-based systems that integrate, control and automate the management of multiple classes of equipment used in the operation of a broadcast studio and satellite uplink facility. In March 2003, we decided to discontinue the operations of Broadcast.

Zyfer provided GPS-aided precision timing and synchronization products, including its CommSynch II product family and its digital timing subsystems for the cellular telephone industry. In May 2003, we sold substantially all of the assets of our Zyfer subsidiary for a

purchase price of \$2.3 million in cash plus future incentive payments of up to \$1 million in each of the years ended April 30, 2004 and 2005. The amount of these future incentive payments will be based on the revenues generated by the sale of Zyfer's products or the license of its technologies.

During the quarter ended December 31, 2000, we began a restructuring to reduce our overall expenses and to focus our business on those areas that we believe would provide the highest return for our stockholders. This restructuring resulted in a 25% reduction in our workforce in the fiscal year ended March 31, 2001 ("fiscal 2001") as compared to the prior year and the discontinuation of certain product lines. In September 2001, in connection with continued cost control efforts and the slowdown in the telecommunications industry, our Board of Directors approved the immediate discontinuation of Mariner Networks, Inc., our wholly-owned subsidiary, which was historically part of our telecom segment. Mariner had previously been a manufacturer of telecommunications equipment.

As a result of the sale of the Gyr CCTV Products line and the discontinuation of Mariner Networks, we reorganized our European operations and reduced our overall staffing levels. The reorganization of the European operations included the discontinuation of our Odetics Europe Ltd., Gyr Europe Ltd., Mariner France and Mariner Europe Ltd. operations, and the transition of our Broadcast and MAXxess international operations to branch office operations with the intent of lowering our international costs. In connection with this restructuring, 34 employees were terminated in the quarter ended December 31, 2001 and 78 employees were terminated in the quarter ended March 31, 2002.

In fiscal 2003, in order to further align our operations with our objectives of pursuing business opportunities focused in the ITS and security markets, we began the process of selling the assets of Zyfer and discontinuing the manufacturing operations of Broadcast referenced above. In the fourth quarter of fiscal 2003, we incurred a loss from discontinued operations of \$6.3 million related to the wind-down of Broadcast. The operations of Broadcast currently consist of seven people at March 31, 2003, all of whom are focused solely on servicing existing customer commitments and contracts for product and system service through their expiration dates.

In the fiscal year ending March 31, 2004, we anticipate that we will only be operating in two business segments. ITS and Security Products, consisting of Iteris, Inc. and MAXxess Systems, Inc. respectively.

Our financial statements contained in this report have been restated for all periods reported to reflect the discontinuation of the operations of Broadcast, Mariner Networks and Zyfer and, accordingly, only reflect the operations of Iteris and MAXxess.

We have generated net losses from operations of \$203,000 in fiscal 2003, \$2.8 million in fiscal 2002 and \$15.9 million in fiscal 2001. While we have substantially reduced our operating losses in recent periods, we have experienced negative cash flows from operations in the amount of \$4.8 million in fiscal 2003, \$18.2 million in fiscal 2002 and \$20.1 million in fiscal 2001, and had a stockholders' deficit of \$4.3 million at March 31, 2003. We expect that our operations will continue to use net cash at least through the end of calendar 2003. We also expect to have an ongoing need to raise cash by securing additional debt or equity financing, or by divesting certain assets to fund our operations until we return to profitability and positive operating cash flows. We cannot assure you that any additional funding will be available on a timely basis, on acceptable terms, or at all. These conditions, together with our recurring losses, cash requirements and stockholders' deficiency, raise substantial doubt about our ability to continue as a going concern.

Critical Accounting Policies And Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our consolidated financial statements included herein, which have been prepared in accordance with accounting principles generally accepted in the 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 disclosure 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 receivables, the valuation of inventories, the recoverability of long-lived assets, including goodwill, and reserves for restructuring and related activities. We base these estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. These estimates and assumptions by their nature involve risks and uncertainties, and may prove to be inaccurate. In the event that any of our estimates or assumptions are inaccurate in any material respect, it could have a material adverse effect on our reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

The following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition. We record product revenues and related cost 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 probable. Accordingly, at the

date revenue is recognized, the significant uncertainties concerning the sale have been resolved. Unless otherwise stated in our product literature, we provide a one to two year warranty on all product material and workmanship, and establish reserves for potential warranty returns as products are shipped. Defective products are either repaired or replaced, at our option, upon meeting certain criteria.

Contract revenue is derived primarily from long-term contracts with governmental agencies. Contract revenue includes 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. We record a charge to earnings for any anticipated losses on contracts in the period in which such losses are identified. Changes in job performance and estimated profitability, including those arising from contract penalty provisions and final contract settlements, may result in revisions to cost and revenue and are recognized in the period in which the revisions are determined. We include profit incentives in revenue in the period in which their realization is reasonably assured.

We record revenues from follow-on service and support, for which we charge separately, in the period in which such services are performed.

Accounts Receivable. We estimate the collectibility of customer receivables on an ongoing basis by periodically reviewing invoices outstanding over a certain period of time. We have recorded reserves for receivables deemed to be at risk for collection as well as a general reserve based on our historical collections experience. A considerable amount of judgment is required in assessing the ultimate realization of these receivables, including the current credit-worthiness of each customer. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make required payments, additional allowances may be required which could adversely affect our operating results.

Inventory. We state our inventories at the lower of cost or market and provide reserves for potentially excess and obsolete inventory. In assessing the ultimate realization of inventories, we make judgments as to future demand requirements and compare that with the current or committed inventory levels. Reserves are established for inventory levels that exceed future demand. It is possible that reserves over and above those already established may be required in the future if market conditions for our products should deteriorate.

Impairment of Assets and Restructuring. During fiscal 2003, we recorded reserves and asset write-downs in connection with the sale of substantially all of the assets of Zyfer and the discontinuation of Broadcast. These include estimates pertaining to the fair value of assets and facility closure costs.

Although we do not anticipate significant changes, the actual assets values and closure costs may differ from the amounts estimated.

Results of Operations

The following table sets forth certain income statement data as a percentage of total net sales and contract revenues for the periods indicated and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations.

	Fiscal Year Ended March 31,		
	2001	2002	2003
Net sales and contract revenues:			
Net sales	67.9%	56.2%	47.3%
Contract revenues	32.1	43.8	52.7
Total net sales and contract revenues	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of net sales	49.7	32.1	24.0
Cost of contract revenues	22.1	25.2	33.7
Selling, general and administrative expense	40.4	35.4	33.8
Research and development expense	12.1	8.4	8.9
Restructuring charges	1.2	4.2	—
Total costs and expenses	(125.5)	(105.3)	(100.4)
Loss from operations	(25.5)	(5.3)	(0.4)
Non-operating income (expense):			
Royalty income	28.6	—	—
Other income	2.1	5.5	.8
Interest expense, net	(2.8)	(8.0)	(1.6)

Income (loss) before tax	2.4	(7.8)	(1.2)
Income tax benefit	—	1.5	—
Income (loss) from continuing operations before minority interest	2.4	(6.3)	(1.2)
Minority interest in earnings of subsidiary	—	(3.7)	(8.0)
Income (loss) from continued operations	2.4	(9.9)	(9.2)
Income (loss) from discontinued operations, net of income tax	(54.5)	(40.3)	(18.4)
Extraordinary loss from early extinguishment of debt	—	(0.8)	—
Net loss	(52.1)%	(51.0)%	(27.6)%

Net Sales and Contract Revenues. Net sales and contract revenues consist of (i) sales of products and services to commercial and municipal agencies ("net sales") and (ii) revenues derived from contracts with state, county and municipal agencies for ITS projects ("contract revenues"). We currently have a diverse customer base and no customer constituted over 10% of our total net sales and contract revenues for fiscal year ended March 31, 2003 ("fiscal 2003"). Total net sales and contract revenues decreased 8.7% to \$47.6 million for fiscal 2003 compared to \$52.2 million for the fiscal year ended March 31, 2002 ("fiscal 2002"), and decreased 16.4% for the fiscal year ended March 31, 2002 compared to \$62.4 million for the fiscal year ended March 31, 2001 ("fiscal 2001"). Sales of Iteris' transportation management systems and video sensor systems represented 86.9% of our total net sales

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and contract revenues for fiscal 2003, 71.5% in fiscal 2002 and 40.4% in fiscal 2001. We anticipate that Iteris will continue to represent a majority of our total net sales and contract revenues for the fiscal year ending March 31, 2004. Sales of Iteris' Vantage vehicle detection systems represented 37.0% of our consolidated net sales and contract revenues in fiscal 2003, 29.4% in fiscal 2002, and 16.0% in fiscal 2001. Contract revenues in Iteris systems represented 46.8% of consolidated net sales and contract revenues in fiscal 2003, 38.7% in fiscal 2002 and 27.9% in fiscal 2001.

Net sales decreased 23.2% to \$22.5 million in fiscal 2003 compared to \$29.3 million in fiscal 2002. The decrease in net sales in fiscal 2003 compared to fiscal 2002 was primarily attributable to our sale of the Gyr CCTV Products line late in the second quarter of fiscal 2002. Sales from Gyr's CCTV Products line contributed \$8.3 million in fiscal 2002 and \$0 in fiscal 2003. After excluding the revenue from Gyr's CCTV Products line in fiscal 2002, net sales in fiscal 2003 increased approximately 8.5% over net sales in fiscal 2002, which primarily reflects an increase in the unit sales of Iteris' Vantage vehicle detection systems, and to a lesser extent increased sales of our Iteris' AutoVue lane departure warning systems.

Net sales decreased 30.7% to \$29.3 million in fiscal 2002 compared to \$42.4 million in fiscal 2001 principally as a result of the sale of our Gyr CCTV Products line, and a decrease in MAXxess unit net sales. Gyr CCTV Products sales comprised \$26.4 million and \$8.3 million of net sales in fiscal 2001 and fiscal 2002, respectively. Gyr CCTV Products sales in fiscal 2002 include sales only through the date of the divestiture. The \$18.1 million decline in sales of Gyr CCTV Products was partially offset by increased unit sales of Vantage vehicle detection systems and AutoVue lane departure warning systems sold. The decrease in MAXxess net sales primarily reflects the decrease in sales to a major telecommunications customer in fiscal 2002 compared to fiscal 2001.

Contract revenues increased 9.8% to \$25.1 million in fiscal 2003 compared to \$22.8 million in fiscal 2002, and increased 14.0% compared to \$20.0 million in fiscal 2000. The increase in contract revenues in both fiscal 2003 and fiscal 2002 primarily reflects an increase in Iteris' contract revenues for ITS projects.

Contract revenues derived from Iteris represented 88.8% of total contract revenues in fiscal 2003 compared to 88.4% of total contract revenues in fiscal 2002, and 87.0% of total contract revenues in fiscal 2001. The balance of the contract revenues were derived from the sale of space-borne recorders and related service and equipment to agencies of the United States Government. In March 2003, we were notified that our contract to provide continued maintenance for space-borne recorders for the United States Government would not be renewed and we do not anticipate any future revenue from this activity.

Gross Profit. Total gross profit decreased 9.5% to \$20.2 million in fiscal 2003 compared to \$22.3 million in fiscal 2002, and increased 26.8% in fiscal 2002 compared to \$17.6 million in fiscal 2001. Total gross profit as a percent of net sales and contract revenues decreased to 42.3% in fiscal 2003 compared to 42.7% in fiscal 2002 and 28.2% in fiscal 2001. Gross profit as a percentage of net sales increased to 49.3% in fiscal 2003 compared to 42.9% in fiscal 2002 and 26.8% in fiscal 2001.

The increase in gross profit as a percent of net sales in fiscal 2003 compared to 2002 reflects a 350 basis point increase in gross profit on sales of Iteris' Vantage video detection systems, in conjunction with a 14.8% increase in sales of these products in fiscal 2003 compared to 2002. Gross profit on MAXxess sales, as a percent of net sales, was relatively unchanged in fiscal 2003 compared to fiscal 2002. Fiscal 2002 revenues and gross profits included revenue contribution from the Gyr CCTV Products line, at lower gross profits relative to net sales. The

divestiture of this product line in September 2001 had the effect of increasing our consolidated gross profit performance beginning in the third quarter of fiscal 2002, which contributed to an overall increase in gross profit in fiscal 2003 compared to fiscal 2002.

Gross profit in fiscal 2001 was net of charges of \$3.1 million for the write-off of inventories associated with discontinued product lines. Before the effect of these write-offs, gross profit as percent of net sales in fiscal 2001 was 33.2%. The increase in gross profit as a percent of net sales in fiscal 2002 compared to fiscal 2001 primarily reflects increased gross profit on Iteris' net sales. Iteris' gross profit improved in fiscal 2002 primarily as a result of a 53.5% increase in Vantage sales and related improved manufacturing efficiencies. The increase in gross profit in fiscal 2002 also reflects the benefit of the divestiture of the Gyr CCTV Products line, which had historically low gross margins relative to net sales in fiscal 2001.

Gross profit as a percent of contract revenues decreased to 36.1% in fiscal 2003 compared to 42.5% in fiscal 2002, and compared to 31.2% in fiscal 2001. This decrease in fiscal 2003 reflects a mix of lower margin contracts in fiscal 2003 as compared to fiscal 2002. Furthermore, gross profit on contract revenues in fiscal 2002 benefited approximately 610 basis points from a \$1.4 million reduction in loss reserves on certain Iteris long-term contracts resulting from changes in the scope of work defined by a major customer, most of which were nonrecurring in fiscal 2003. Net of such adjustments and profit realizations, we anticipate that gross profits as a percent of contract revenues are typically realized in a range of 31.0% to 35.0%, depending upon the mix and scope of work undertaken during any given reporting period. We recognize contract revenues and related gross profit using percentage of completion contract accounting, and the underlying mix of contract activity primarily affects the related gross profit recognized in any given year. As noted above, in March 2003, we were notified that our contract to provide continued maintenance for space-borne recorders for the United States Government would not be renewed and we do not anticipate any future revenue from this activity.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased 12.6% to \$16.2 million (or 33.8% of total net sales and contract revenues) in fiscal 2003 compared to \$18.5 million (or 35.4% of total net sales and contract revenues) in fiscal 2002, and decreased 23.8% in fiscal 2002 compared to \$25.2 million (or 40.4% of total net sales and contract revenues) in fiscal 2001. Approximately \$1.6 million of the decrease in selling, general and administrative expenses in fiscal 2003 compared to 2002 represents the cost reductions associated with the divestiture of the Gyr CCTV Products line in the second quarter of fiscal 2002. The decrease in selling, general and administrative expenses in fiscal 2003 also reflects general cost reductions related to staffing and outside services for legal and accounting expenses, which was partially offset by increased sales and marketing costs in Iteris. The restructuring activities, which commenced during the third quarter of fiscal 2001, resulted in substantial decreases in selling, general and administrative expenses in MAXxess and Iteris in fiscal 2002, which were augmented by further cost reductions associated with the divestiture of the Gyr CCTV Products line in September 2001.

Research and Development Expenses. Research and development expenses decreased 3.9% to \$4.2 million (or 8.9% of total net sales and contract revenues) in fiscal 2003 compared to \$4.4 million (or 8.4% of total net sales and contract revenues) in fiscal 2002, and decreased 41.9% in fiscal 2002 compared to \$7.6 million (or 12.1% of total net sales and contract revenues) in fiscal 2001. For competitive reasons, we closely guard the confidentiality of specific development projects.

The decrease in research and development expenses in fiscal 2003 compared to 2002 reflects the net of increased spending in Iteris and MAXxess, partially offset by cost savings associated with the divestiture of the Gyr CCTV Products line at the end of the second quarter of fiscal 2002. The increases in Iteris relate principally to software algorithm development and new hardware designs for enhancements to its existing product family of Video Detection systems, in addition to development of video detection products that are expected to be announced in fiscal 2004. Increases in research and development expense at MAXxess primarily relate to the software development of new performance feature for its AXxess 202/NS line of electronic access control systems. The features introduced in fiscal 2003 to the AXxess 202/NS product line include a universal gateway for integrating other manufacturers systems and improved data encryption capabilities.

The decrease in research and development expenses in fiscal 2002 was associated with the divestiture of the Gyr CCTV Products line at the end of the second quarter of fiscal 2002, and with a substantial cost reduction in Iteris related to its development of technology to support personalized traveler information systems. The decrease in research and development expense in fiscal 2002 also reflects the full fiscal year cost benefit of the restructuring, which was begun in the fourth quarter of fiscal 2001. The restructuring resulted in substantial decreases in research and development expenditures, primarily in the areas of payroll and related benefits, prototype material costs and consulting fees.

Restructuring Charges. We commenced the restructuring of our business to reduce our overall expenses and to focus our business on those areas that we believe would provide the highest return for our stockholders. The restructuring included a reorganization of our European operations to lower our international costs. The restructuring charge of \$2.2 million in fiscal 2002 reflects charges of approximately \$1.5 million related to the reorganization of our European operations and \$700,000 in severance charges incurred upon the retirement of the former Chief Executive Officer of Odetics.

In fiscal 2001, we incurred restructuring charges of \$0.8 million related to severance payments for staffing reductions across all of our business units.

Royalty Income. During fiscal 2001, in connection with the settlement of patent litigation that Odetics filed against StorageTek, we received proceeds, net of expenses and fees, of approximately \$17.8 million in full settlement of the amounts due to us.

Other Income. Other income, net reflects the following:

	Year Ended March 31,		
	2001	2002	2003
	(in thousands)		
Gain on sale of real estate	\$ —	\$ —	\$ 640
Loss on sale of Iteris common stock	—	(1,596)	(310)
Gain on sale of Gyr assets	—	4,391	—
Gain on sale of solid state recorder assets	1,231	—	—
Other	109	124	58
Other income, net	\$ 1,340	\$ 2,919	\$ 388

Other income, net in fiscal 2003 includes a gain of \$640,000 recognized on the sale and leaseback of our Anaheim, California facility, which was consummated in May 2002. We sold shares of our Iteris common stock that yielded gross proceeds of \$3.8 million and \$900,000 in fiscal 2002 and 2003, respectively. During fiscal 2002, we sold substantially all of the assets of Gyr's CCTV Products line and Gyr's Dome Products line. We realized an aggregate net gain of \$4.4 million on these sales. During fiscal 2001, we sold the assets of our solid state recorder business, which yielded gross proceeds of \$1.9 million and a net gain of \$1.2 million.

Interest Expense, Net. Interest expense, net reflects the net of interest expense and interest income as follows:

	Year Ended March 31,		
	2001	2002	2003
	(in thousands)		
Interest expense	\$ 2,012	\$ 4,190	\$ 761
Interest income	250	—	—
Interest expense, net	\$ 1,762	\$ 4,190	\$ 761

Interest expense decreased 87.7% in fiscal 2003 compared to fiscal 2002 and increased 108.3% in fiscal 2002 compared to fiscal 2001. As a result of the sale and leaseback of our Anaheim, California facilities, we repaid a \$16.4 million outstanding indebtedness under a promissory note in May 2002. The increase in interest expense in fiscal 2002 reflects an increase in our average outstanding borrowings, an increase in our cost of borrowing and \$1.2 million of amortization of debt discount associated with a warrant issued in connection with certain of our financing transactions.

Extraordinary Item. The extraordinary loss incurred in fiscal 2002 relates to a prepayment penalty we incurred in fiscal 2002 in connection with the retirement of our mortgage note payable resulting from the refinancing of our Anaheim real property.

Income Taxes. During fiscal 2002, we recognized an income tax benefit of \$785,000 for the recovery of net operating loss carry backs made available under the Job Creation and Workers Association Act of 2002. We have not provided income tax benefit for the losses incurred in fiscal 2003 due to the uncertainty as to the ultimate realization of the related benefit.

Minority Interest in Subsidiary. The minority interest represents the minority stockholders' share of Iteris' net income or loss and the accretion of the redemption preference of Iteris's Series A preferred stock.

Liquidity and Capital Resources

During fiscal 2003, we used \$4.8 million of cash to fund our operations. Operating cash flow reflects our net loss of \$13.1 million in fiscal 2003 increased for non-cash gains of \$1.7 million related to the sale of our real estate assets, and decreased by \$4.9 million in non-cash reserves for asset impairments related to the write-down of the assets of the discontinued operations of Broadcast and Zyfer, by non-cash charges of \$3.8 million related to the minority interest in our Iteris subsidiary and \$1.1 million for depreciation and amortization. As of March 31, 2003, we had cash of \$437,000.

In May 2002, we completed the sale and leaseback of our Anaheim, California facilities for an aggregate sale price of \$22.6 million. Approximately \$16.4 million of the proceeds from this sale were used to repay the outstanding indebtedness under a promissory note, which was secured by a first deed of trust on our Anaheim facilities. In connection with the sale and leaseback, we pledged cash of \$2.5 million to

secure our obligations under the lease. The pledged amounts will be released to us based upon our continued compliance with financial covenants and performance under the lease. The balance of the proceeds from this sale was used for general working capital purposes. We committed to lease one of the two buildings on this property for a period of ten years, and to lease the other building for a period of 30 months.

On August 16, 2002, we completed a private placement of 2,500,000 of our Class A common stock to an institutional investor for \$3.0 million in cash. The transaction, net of expenses, raised net proceeds of approximately \$2.7 million. In connection with this offering, we also issued warrants to the investor to purchase up to another 1,250,000 shares at an exercise price of \$1.50 per share, and up to 1,250,000 shares at an exercise price of \$1.80 per share. The warrants are exercisable at any time by the investor, and are callable by us if the market price of our Class A common stock trades for 20 consecutive days at a price equal or greater than two times the exercise price of the warrants. If all of the warrants are exercised, the total gross proceeds from this transaction are expected to be \$7.2 million. The proceeds from the transaction were used to fund general working capital requirements.

In May 2003, we completed the sale of substantially all the assets of our wholly-owned subsidiary, Zyfer, Inc., for \$2.3 million in cash plus the assumption of liabilities. The cash proceeds were used to fund working capital requirements and pay short-term liabilities. The asset purchase agreement provides for future incentive payments to us of up to \$1.0 million in each of the twelve months ended

April 30, 2004 and 2005 based upon the achievement of certain revenues goals related to the sale of Zyfer products or the licensing of its technologies.

Our contractual obligations are as follows at March 31, 2003:

	Payments Due by Period				
	Total	One Year or Less	Two to Three Years	Four to Five Years	After Five Years
	(in thousands)				
Lines of credit	1,485	235	1,250	—	—
Operating leases	17,417	2,171	3,975	3,663	7,608
Total	18,902	2,406	5,225	3,663	7,608

We expect that our operations will continue to use net cash at least through the end of calendar 2003. We also expect to have an ongoing need to raise cash by securing additional debt or equity financing, or by divesting certain assets to fund our operations until we return to profitability and positive operating cash flows. We believe that our future ability to obtain additional funding will be dependent upon our ability to narrow our operating losses and provide a favorable expectation of future operating profitability. We believe our ability to raise additional capital may also be adversely affected if Nasdaq determines to delist our Class A common stock from the Nasdaq SmallCap Market. The steps undertaken in fiscal 2002 and fiscal 2003 were intended to lower our operating costs, widen our gross profits, and generally provide more opportunity to return to profitability. Furthermore, we believe that a focused business model provides a more compelling opportunity for appreciation in stockholder value. Notwithstanding the recent refinements to our business model and our more defined focus, we cannot be certain that we will be able to secure additional debt or equity financing on terms acceptable to us, on a timely basis, or at all.

Our future cash requirements will be highly dependent upon our ability to control expenses, as well as the successful execution of the revenue plans by both Iteris and MAXcess. A critical element of controlling expenses relates to the restructuring of our facilities lease arrangements. We are currently in negotiations with our landlords to restructure our leases for our principal facilities in order to reduce our overall operating expenses to a level commensurate with our existing operations. We cannot be assured of the outcome of these negotiations and, as a result, any projections of future cash requirements and cash flows are subject to substantial uncertainty.

These conditions, together with our recurring losses, raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or liabilities that may result from the outcome of this uncertainty.

Recent Accounting Pronouncements

In 2003, we adopted Statement of Financial Accounting Standards No. 141, *Business Combinations* ("SFAS 141"). SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. Application of this statement did not have a significant effect on our consolidated results of operations or financial position.

In July 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ("Statement 146"). Statement 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)* ("EITF 94-3"). Statement 146 requires that a liability for a cost associated

with an exit or disposal activity be recognized when the liability is incurred. We adopted the provisions of Statement 146 on January 1, 2003.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ("FIN 45"), effective prospectively for guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for periods ending after December 15, 2002. Under FIN 45, a guarantor is required to recognize, at the inception of certain guarantees, a fair value liability for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. All guarantees subject to the disclosure provisions of FIN 45, such as product warranties, have been disclosed in the accompanying notes to the consolidated financial statements. We do not have any other outstanding guarantees at March 31, 2003 required to be disclosed or recorded as obligations upon adoption of FIN 45.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"). This Interpretation changes the method of determining whether certain entities should be included in our consolidated financial statements. An entity is subject to FIN 46 and is called a variable interest entity ("VIE") if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make significant decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. All other entities are evaluated for consolidation under SFAS No. 94, *Consolidation of All Majority-Owned Subsidiaries*. The provisions of FIN 46 are to be applied immediately to VIEs created after January 31, 2003, and to VIEs in which an enterprise obtains an interest after that date. For VIEs in which an enterprise holds a variable interest that it acquired before February 1, 2003, FIN 46 applies in the first fiscal period beginning after June 15, 2003. We have not yet determined the impact, if any, that the adoption of FIN 46 will have on our financial position, results of operations or cash flows.

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 together information contained in this report and our other filings with the SEC, including our subsequent reports on Forms 10-Q and 8-K before deciding to buy, sell or hold our common stock. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. If any of these risks actually occurs, our business, financial condition or results of operations could be seriously harmed. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

We Have Experienced Substantial Losses and May Continue to Experiencing Losses for the Foreseeable Future. We experienced losses from continuing operations of \$4.4 million in the year ended March 31, 2003 and \$5.2 million in the year ended March 31, 2002. In the three months ended September 30, 2001, we downsized our business in connection with our sale of the Gyr CCTV Products line, the discontinuation of the business of our Mariner Networks subsidiary and the reorganization of our European operations to reduce our operating expenses. In addition, in May 2003, we sold our Zyfer business and we are continuing to explore the divestiture of the assets related to our Broadcast business. We cannot assure you that our efforts to downsize our operations or reduce our operating expenses or sell portions of our business 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, and 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 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 Will 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 in recent periods, and have experienced negative cash flows from operations of \$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 the sale of our Anaheim, California property in May 2002 and the sale of our Zyfer subsidiary in May 2003, the majority of the proceeds from such sales were used to pay outstanding debts and accounts payables. In addition, \$3.0 million of the proceeds from the sale of the Anaheim property have been pledged to secure our performance under the leases for our Anaheim facility and we have yet to monetize the assets of our Broadcast subsidiary. As of March 31, 2003, our cash balance was approximately \$0.4 million and we anticipate that we will need to raise additional capital in the future. Our Iteris 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 have been pledged to the lender to secure the outstanding indebtedness under this facility (although there were no amounts outstanding under the line of credit at March 31, 2003).

We plan to raise additional capital in the near future, either through bank borrowings, other debt or equity financings, or the divestiture of additional business units or select assets. 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:

- 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;

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- our ability to renegotiate our real property leases;
- increased research and development funding, and required investments in our business units;
- 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.

The Trading Price of Our Common Stock Is Highly Volatile and Our Shares Could be Delisted from the Nasdaq Small Cap Market and You May Not Be Able to Resell Your Shares of Stock at or Above the Price You Paid for Them. 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 April 2002, because we failed to meet the minimum stockholder's equity requirement for continued listing on the Nasdaq National Market, both our Class A common stock and Class B common stock were delisted from the Nasdaq National Market and subsequently approved for listing on the Nasdaq SmallCap Market. In November 2002, we received a Nasdaq Staff Determination that we had not maintained compliance with the continued listing criteria and that our common stock was subject to delisting from the Nasdaq SmallCap Market. Our Class B common stock was delisted from the Nasdaq SmallCap Market in April 2003. We requested and received an extension of such delisting proceedings but subsequently received, in May 2003, a second Nasdaq Staff Determination stating that we were not in compliance with the continued listing criteria, and that our Class A common stock was also subject to delisting from the Nasdaq SmallCap Market. We participated in a hearing before a Nasdaq Listing Qualifications Panel in June 2003 to appeal the Staff Determination but a final determination by the panel has not yet been issued. Odetics' listing status will not change until such final determination has been issued by the panel. However, there can be no assurance that the panel will grant our request for continued listing on the Nasdaq SmallCap Market, and if we are unsuccessful in our appeal and are delisted from the Nasdaq SmallCap Market, there may not be an active trading market for our stock. As such, you may not be able to resell your shares of common stock at or above the price you paid for them.

In the event our Class A common stock is delisted, trading, if any, in our Class A common stock thereafter may be conducted in the over-the-counter market in the so-called "pink sheets" or the OTC Bulletin Board. In addition, our securities could become subject to "penny stock" restrictions, including Rule 15c-9 under the Exchange Act, 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 which could be bought and sold, but

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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 attained.

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;
- shortages announced by suppliers;
- announcements of technological innovations or new products by our competitors, customers or us;
- acquisitions or businesses, products or technologies;
- changes in pending litigation or new litigation;
- changes in investor perceptions;
- our ability to spin-off any business unit;
- applications or product enhancements by us or by our competitors;
- changes in earnings estimates or investment recommendations by securities analysts; and
- international conflicts and political unrest.

The stock market in general has recently experienced volatility, which has particularly affected the market prices of equity securities of many high 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 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;
- 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;
- our significant investment in research and development for our subsidiaries and business units;
- 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;
- 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 sales among our business units;

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- deferrals of customer orders in anticipation of new products, applications or product enhancements;
 - risks and uncertainties associated with our international business;
 - 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.

We Have Adopted a New Operating Strategy, Which Is Untried and Exposes Us to New Risks. Recently, we divested ourselves of many of our business units and have begun to focus our business on the emerging homeland security opportunities and the business of our Iteris subsidiary. We continue to explore options for the sale of our other business units and continue to change our incubator strategy, which required us to make significant investments in our business units with the goal of achieving profitability in each of our business units, and to a lesser extent, to monetize those business units for the benefit of our stockholders through an initial public offering or sale to a strategic buyer. The new focus of our business may not be profitable and the current climate of international conflicts and political unrest may not translate to a profitable market for our products. Our current business strategy is untried there is no assurance that the new business plan or the continued execution of the Iteris business will be successful.

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 target 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 hardware, storage media, operating system software and applications software 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. Iteris currently outsources the manufacture of its 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.

MAXxess is expecting its product offering to include chemical detection systems and a security solution for municipalities called Safe Cities. Our ability to be successful in this endeavor is dependent upon the completion of software development tasks and the continued cooperation of Draeger Safety, Inc.

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.

We Have Significant International Sales and 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, such sales continue to be significant to our business, particularly for our AutoVue and Vantage product lines. International sales represented 1.9% of our net sales and contract revenues for the fiscal year ended March 31, 2003, 3.5% of our net sales and contract revenues for the fiscal year ended March 31, 2002 and 10.3% for the fiscal year ended March 31, 2001. The recent terrorist attacks in the United States and abroad and heightened security may adversely impact our international sales and could make our international operations more expensive.

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;

- 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 international sales will continue to represent a significant portion of our revenues, and 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.

Acquisitions of Companies or Technologies May Require Us to Undertake Significant Capital Infusions and Result in Disruptions of Our Business and Diversion of Resources and Management Attention. Over the past few years, we have expanded our operations and made several substantial acquisitions of diverse businesses, including Meyer Mohaddes Associates, Inc., Viggen Corporation, and certain assets of the Transportation Systems business of Rockwell International. We may continue to engage in acquisitions of 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.

Acquisitions may also materially and adversely affect our operating results due to large write-offs, contingent liabilities, substantial depreciation, deferred compensation charges or goodwill amortization, or other adverse tax or audit consequences. Our failure to manage growth and integrate our acquisitions successfully could adversely affect our business, financial condition and results of operations.

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. We cannot assure you that we will be able to consummate any additional acquisitions, successfully integrate any acquisitions or realize the benefits anticipated from any acquisition.

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 and 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 Do Not Have Employment Agreements with Any Key Personnel and 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 recently retired as our Chief Executive Officer, and Gregory A. Miner, our Chief Executive Officer and Chief Financial Officer. We do not have any employment contracts with any of our officers or key employees. 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 resources, regardless of whether the claim is valid, could be significant and could seriously harm our business, financial condition and results of operations.

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 June 18, 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 party to effect a change in our management and control. In addition, 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, as well as additional shares of Class B common stock. Our future issuance of preferred stock or Class B common stock could be used to discourage an unsolicited acquisition proposal.

In March 1998, we adopted a stockholder rights plan and declared a dividend of preferred stock purchase rights to our stockholders. In the event a third party acquires more than 15% of the outstanding voting control of our company or 15% of our outstanding common stock, the holders of these rights will be able to purchase the junior participating preferred stock at a substantial discount off of the then current market price. The exercise of these rights and purchase of a significant amount of stock at below market prices could cause substantial dilution to a particular acquiror and discourage the acquiror 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.

We Do Not Pay Cash Dividends. We have never paid cash dividends on our common stock and do not anticipate paying any cash dividends on either class of our common stock in the foreseeable future.

We May Be Subject to Additional Risks. The risks and uncertainties described above 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 adversely affect our business operations.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

Our exposure to interest rate risk is limited to our lines of credit. Iteris' and Odetics' lines of credit bear interest at the prevailing prime rate, plus 2% and 4%, respectively. Our \$16.0 million note payable, prior to its repayment in May 2002, carried a fixed rate of interest. We estimate that, based on amounts outstanding at March 31, 2003, a 10% increase in the prime rate would result in an increase in interest expense, on an annualized basis, of less than \$0.1 million.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The financial statements and supplementary data required by Regulation S-X are included in this Form 10-K commencing on page F-1.

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

Not applicable.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Directors and Executive Officers

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

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

(c) *Compliance with Section 16(a) of the Exchange Act.* The information under the caption "Executive Compensation and Other Information," appearing in our proxy statement, is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION.

The information under the caption "Executive Compensation and Other Information," appearing in our proxy statement, is incorporated herein by reference.

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

As of March 31, 2003, Odetics had only one plan, the 1997 Stock Incentive Plan, pursuant to which equity securities of Odetics are authorized for issuance. The following table sets forth certain information regarding this plan:

(a)	(b)	(c)
Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available under Equity Compensation Plans (excluding some securities reflected in column (a))

<i>Security Holders</i>			
1997 Stock Incentive Plan	961,920	\$3.73	689,000
<i>Equity Compensation Plans Not Approved by Security Holders</i>			
None			
Total	961,920		689,000

The information under the caption "Principal Stockholders and Common Stock Ownership of Certain Beneficial Owners and Management," appearing in our proxy statement, is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information under the caption "Certain Transactions," appearing in our proxy statement, is incorporated herein by reference.

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ITEM 14. CONTROLS AND PROCEDURES.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information 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, 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, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Within 90 days prior to the date of this Report, the Company carried out an evaluation, under the supervision and with the participation of 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. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

There have been no significant changes in our internal controls or in other factors that could significantly affect the internal controls subsequent to the date we completed our evaluation.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) Documents filed as part of this report:

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

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2. Financial Statement Schedules.

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All other schedules have been omitted because they are not required or the required information is included in our consolidated financial statements and notes thereto.

3. (a) Exhibits.

- 3.1 Certificate of Incorporation of Odetics, as amended (incorporated by reference to Exhibit 19.2 to Odetics' Quarterly Report on Form 10-Q for the quarter ended September 30, 1987).
- 3.2 Bylaws of Odetics, as amended (incorporated by reference to Exhibit 4.2 to Odetics' Registration Statement on Form S-1 (Reg. No. 033-67932) as filed with the SEC on July 6, 1993).
- 4.1 Specimen of Class A common stock and Class B common stock certificates (incorporated by reference to Exhibit 4.3 to Amendment No. 1 to Odetics' Registration Statement on Form S-1 (Reg. No. 033-67932) as filed with the SEC on September 30, 1993).
- 4.2 Form of rights certificate for Odetics' preferred stock purchase rights (incorporated by reference to Exhibit A of Exhibit 4 to Odetics' Current Report on Form 8-K as filed with the SEC on May 1, 1998).
- 10.1 Profit Sharing Plan and Trust (incorporated by reference to Exhibit 10.3 to Odetics' Amendment No. 2 to the Registration Statement on Form S-8 (Reg. No. 002-98656) as filed with the SEC on May 5, 1988).
- 10.2 Form of Executive Deferral Plan between Odetics and certain employees of Odetics (incorporated by reference to Exhibit 10.4 to Odetics' Annual Report on Form 10-K for the year ended March 31, 1988).
- 10.3 Form of Indemnity Agreement entered into by Odetics and certain of its officers and directors (incorporated by reference to Exhibit 19.4 to Odetics' Quarterly Report on Form 10-Q for the quarter ended September 30, 1988).
- 10.4 Amendment Nos. 3 and 4 to the Profit Sharing Plan and Trust (incorporated by reference to Exhibits 4.3.1 and 4.3.2, respectively, to Amendment No. 3 to Odetics' Registration Statement on Form S-3 (Reg. No. 002-86220) as filed with the SEC on June 13, 1990)
- 10.5 1997 Stock Incentive Plan of Odetics (as amended on May 3, 2002).
- 10.6 Form of Notice of Grant of Stock Option (incorporated by reference to Exhibit 99.2 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000)
- 10.7 Form of Stock Option Agreement (incorporated by reference to Exhibit 99.3 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000).
- 10.8 Form of Addendum to Stock Option Agreement—Involuntary Termination Following Corporate Transaction or Change in Control (incorporated by reference to Exhibit 99.4 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000).
- 10.9 Form of Addendum to Stock Option Agreement—Limited Stock Appreciation Rights (incorporated by reference to Exhibit 99.5 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000).
- 10.10 Form of Stock Issuance Agreement (incorporated by reference to Exhibit 99.6 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000)

- 10.11 Form of Addendum to Stock Issuance Agreement—Involuntary Termination Following Corporate Transaction/Change in Control (incorporated by reference to Exhibit 99.7 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000).
- 10.12 Form of Notice of Grant of Automatic Stock Option—Initial Grant filed as Exhibit 99.8 filed as Exhibit (incorporated by reference to Exhibit 99.8 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000).
- 10.13 Form of Notice of Grant of Automatic Stock Option—Annual Grant (incorporated by reference to Exhibit 99.9 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 14, 2000).
- 10.14 Form of Automatic Stock Option Agreement filed as Exhibit 99.10 to the (incorporated by reference to Exhibit 99.10 to Odetics' Registration Statement on Form S-8 (File No. 333-30396) as filed with the SEC on February 19, 2000).
- 10.15 Rights Agreement dated April 24, 1998 between Odetics and BankBoston, N.A., which includes the form of Certificate of

Designation for the junior participating preferred stock as Exhibit A, the form of rights certificate as Exhibit B and the summary of rights to purchase Series A preferred shares as Exhibit C (incorporated by reference to Exhibit 4 to Odetics' Current Report on Form 8-K as filed with the SEC on May 1, 1998).

- 10.16 1994 Long-Term Equity Plan of Odetics (incorporated by reference to Exhibit 4.3 to Odetics' Registration Statement on Form S-8 (File No. 333-05735) as filed with the SEC on June 11, 1996).
- 10.17 Amendment to Rights Agreement, dated May 21, 2001, by and between Odetics and Fleet National Bank (a.k.a. Bank Boston, N.A.) (incorporated by reference to Exhibit 99.4 to Odetics' Current Report on Form 8-K as filed with the SEC on June 1, 2001).
- 10.18 Amended and Restated Agreement of Purchase and Sale and Escrow Instructions, dated February 19, 2002, by and between Odetics, Inc. and 1515 South Manchester, LLC (incorporated by reference to Exhibit 2.1 to Odetics' Current Report on Form 8-K as filed with the SEC on June 12, 2002).
- 10.19 Sublease Agreement dated May 7, 2003 by and between Odetics, Inc. and FEI-Zyfer, Inc.
- 21 Subsidiaries of Odetics.
- 23.1 Consent of Independent Auditors.
- 99.1 Section 906 Certification, as furnished by the Chief Executive Officer and Chief Financial Officer pursuant to SEC Release No. 33-8212, 34-47551.

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended March 31, 2003.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Anaheim, State of California, on June 27, 2003.

ODETICS, INC.

By: /s/ GREGORY A. MINER

Gregory A. Miner,
*Chief Executive Officer
and Chief Financial Officer*

POWER OF ATTORNEY

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

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

Signature	Title	Date
<hr/> /s/ GREGORY A. MINER	Director, Chief Executive Officer and Chief Financial Officer	June 27, 2003
<hr/> Gregory A. Miner (principal executive officer and principal financial officer)		

/s/ JOEL SLUTZKY

Joel Slutzky

Chairman of the Board

June 27, 2003

/s/ KEVIN C. DALY

Kevin C. Daly, Ph.D

Director

June 27, 2003

/s/ CRANDALL GUDMUNDSON

Crandall Gudmundson

Director

June 27, 2003

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/s/ JERRY MUENCH

Jerry Muench

Director

June 27, 2003

/s/ JOHN SEAZHOLTZ

John Seazholtz

Director

June 27, 2003

/s/ GARY SMITH

Gary Smith

Vice President and Controller (principal accounting officer)

June 27, 2003

/s/ THOMAS L. THOMAS

Thomas L. Thomas

Director

June 27, 2003

/s/ PAUL E. WRIGHT

Paul E. Wright

Director

June 27, 2003

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CERTIFICATION

I, Gregory A. Miner, certify that:

1. I have reviewed this annual report on Form 10-K of Odetics, Inc.
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a. designed such disclosure controls and procedures 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 annual report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of

directors (or persons performing the equivalent functions):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 27, 2003

/s/ GREGORY A. MINER

Gregory A. Miner,
Chief Executive Officer and Chief Financial Officer
(Principal Executive Officer and Principal Financial Officer)

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Odetics, Inc.

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Report of Independent Auditors

Stockholders and Board of Directors
Odetics, Inc.

We have audited the accompanying consolidated balance sheets of Odetics, Inc. as of March 31, 2002 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended March 31, 2003. Our audits also included the financial statement schedule listed in Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Odetics, Inc. at March 31, 2002 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended March 31, 2003, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's recurring losses from operations raise substantial doubt about its ability to continue as a going concern. Management's plans as to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/Ernst & Young LLP

Orange County, California
June 3, 2003

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Odetics, Inc.

Consolidated Balance Sheets

(In thousands, except share and per share amounts)

	March 31,	
	2002	2003
Assets		
Current assets:		
Cash and cash equivalents	\$ 408	\$ 437
Trade accounts receivable, net of allowance for doubtful accounts of \$115 in 2002 and \$156 in 2003	8,617	8,549
Costs and estimated earnings in excess of billings on uncompleted contracts	3,565	2,398
Inventories:		
Finished goods	155	211
Work in process	25	419
Materials and supplies	3,528	3,634
Prepaid expenses and other	1,621	435
Assets of discontinued operations	8,525	4,392
Total current assets	26,444	20,475
Restricted cash	—	2,516
Property, plant and equipment:		
Land	2,060	—
Buildings and improvements	19,005	43
Equipment	7,322	7,256
Allowances for depreciation	(12,390)	(5,336)
	15,997	1,963
Goodwill	9,769	9,807
Other assets	28	81
Total assets	\$ 52,238	\$ 34,842
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Trade accounts payable	\$ 4,646	\$ 5,862
Accrued payroll and related	4,696	5,731
Accrued expenses	1,761	858
Billings in excess of costs and estimated earnings on uncompleted contracts	2,236	304
Advances under receivables purchase agreement with related party	—	235
Liabilities of discontinued operations	4,585	4,139
Current portion of long-term debt	16,124	—

Total current liabilities	34,048	17,129
Revolving line of credit	767	—
Revolving line of credit with related party	1,250	1,250
Deferred gain on sale of building	—	6,025
Other liabilities	25	15
Minority interest	10,893	14,711
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred stock:		
Authorized shares—2,000,000		
Issued and outstanding—none	—	—
Common stock, \$.10 par value:		
Authorized shares—50,000,000 of Class A and 2,600,000 of Class B		
Issued and outstanding shares—11,490,530 of Class A and 1,035,841 of Class B at March 31, 2002; 14,080,914 of Class A and 1,035,841 of Class B at March 31, 2003	1,252	1,512
Paid-in capital	89,134	92,819
Treasury stock, 93 and 93 shares in 2002 and 2003, respectively	(1)	(1)
Notes receivable from employees	(51)	(51)
Accumulated other comprehensive income	241	(99)
Accumulated deficit	(85,320)	(98,468)
Total stockholders' equity (deficit)	5,255	(4,288)
Total liabilities and stockholders' equity (deficit)	\$ 52,238	\$ 34,842

See accompanying notes.

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Odetics, Inc.

Consolidated Statements of Operations

(In thousands, except per share information)

	Year ended March 31,		
	2001	2002	2003
Net sales and contract revenues:			
Net sales	\$ 42,363	\$ 29,343	\$ 22,541
Contract revenues	20,039	22,846	25,086
	62,402	52,189	47,627
Costs and expenses:			
Cost of sales	31,028	16,769	11,424
Cost of contract revenues	13,781	13,132	16,034
Selling, general and administrative expenses	25,219	18,491	16,157
Research and development expenses	7,549	4,385	4,215
Restructuring charges	757	2,189	—
	78,334	54,966	47,830
Loss from operations	(15,932)	(2,777)	(203)
Non-operating income (expense)			
Royalty income	17,825	—	—
Other income, net	1,340	2,919	388
Interest expense, net	(1,762)	(4,190)	(761)
Income (loss) before income tax	1,471	(4,048)	(576)

Income tax benefit	—	785	—
Income (loss) from continuing operations before minority interest	1,471	(3,263)	(576)
Minority interest in earnings of subsidiary	—	(1,910)	(3,818)
Income (loss) from continuing operations	1,471	(5,173)	(4,394)
Loss from discontinued operations, net of taxes of \$0	(34,011)	(20,965)	(8,754)
Extraordinary loss from early extinguishment of debt, net of tax of \$0	—	(450)	—
Net loss	\$ (32,540)	\$ (26,588)	\$ (13,148)
Basic earnings (loss) per share:			
Continuing operations	\$ 0.15	\$ (0.46)	\$ (0.31)
Discontinued operations	(3.41)	(1.86)	(0.61)
Extraordinary loss	—	(0.04)	—
Basic loss per share	\$ (3.26)	\$ (2.36)	\$ (0.92)
Diluted earnings (loss) per share:			
Continuing operations	\$ 0.14	\$ (0.46)	\$ (0.31)
Discontinued operations	(3.33)	(1.86)	(0.61)
Extraordinary loss	—	(0.04)	—
Diluted loss per share	\$ (3.19)	\$ (2.36)	\$ (0.92)
Shares used in computing basic earnings (loss) per share	9,977	11,267	14,276
Shares used in computing diluted earnings (loss) per share	10,209	11,267	14,276

See accompanying notes.

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Odetics, Inc.

Consolidated Statements of Stockholders' Equity

(In thousands)

	Common stock		Amount	Paid-in capital	Treasury stock	Notes receivable from employees	Accumulative other comprehensive income	Accumulated deficit	Total	Comprehensive income
	Shares outstanding									
	Class A common stock	Class B common stock								
Balance at March 31, 2000	8,183	1,052	\$ 923	\$ 61,200	\$ (22)	\$ (61)	\$ 262	\$ (26,192)	\$ 36,110	\$ —
Issuances of Odetics common stock	1,270	—	127	17,348	21	—	—	—	17,496	—
Conversion of Class B common stock	16	(16)	—	—	—	—	—	—	—	—
Payments on notes receivable	—	—	—	—	—	10	—	—	10	—
Foreign currency translation adjustments	—	—	—	—	—	—	(698)	—	(698)	(698)
Net loss	—	—	—	—	—	—	—	(32,540)	(32,540)	(32,540)
Balance at March 31, 2001	9,469	1,036	1,050	78,548	(1)	(51)	(436)	(58,732)	20,378	(33,238)
Issuances of Odetics common stock	2,022	—	202	3,716	—	—	—	—	3,918	—
Issuance of Iteris common	—	—	—	5,513	—	—	—	—	5,513	—

stock										
Issuance of warrants	—	—	—	1,357	—	—	—	1,357	—	—
Foreign currency translation adjustments	—	—	—	—	—	—	677	—	677	677
Net loss	—	—	—	—	—	—	—	(26,588)	(26,588)	(26,588)
Balance at March 31, 2002	11,491	1,036	1,252	89,134	(1)	(51)	241	(85,320)	5,255	(25,911)
Issuances of Odetics common stock	2,590	—	260	2,814	—	—	—	—	3,074	—
Issuance of Iteris common stock	—	—	—	871	—	—	—	—	871	—
Foreign currency translation adjustments	—	—	—	—	—	—	(340)	—	(340)	(340)
Net loss	—	—	—	—	—	—	—	(13,148)	(13,148)	(13,148)
Balance at March 31, 2003	14,081	1,036	\$ 1,512	\$ 92,819	\$ (1)	\$ (51)	\$ (99)	\$ (98,468)	\$ (4,288)	\$ (13,488)

See accompanying notes.

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Odetics, Inc.
Consolidated Statements of Cash Flows
(In thousands)

	Year ended March 31,		
	2001	2002	2003
Operating activities			
Net loss	\$ (32,540)	\$ (26,588)	\$ (13,148)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	4,967	3,776	816
Amortization of warrants	—	1,230	246
Amortization of deferred gain on sale-leaseback	—	—	(1,665)
Write-off of discontinued subsidiaries	—	8,361	4,909
Minority interest in earnings of subsidiary	—	1,910	3,818
Loss on sale of Iteris common stock	—	1,597	310
Loss on disposal of assets	—	48	2
Write-off of capitalized software	4,014	—	—
Gain on sale of product lines	(1,230)	(3,385)	—
Provision for losses on accounts receivable	78	102	—
Changes in operating assets and liabilities (Note 15)	4,621	(5,284)	(77)
Net cash provided by (used in) operating activities	(20,090)	(18,233)	(4,789)
Investing activities			
Purchases of property, plant and equipment, net	(2,502)	(426)	(518)
Repurchase of real estate option	(5,000)	—	—
Proceeds from sale of product lines	1,877	9,884	—
Proceeds from sale of building	—	—	18,951
Purchase of net assets of acquired business	(42)	(200)	—
Other	(688)	677	(340)
Net cash provided by (used in) investing activities	(6,355)	9,935	18,093
Financing activities			
Proceeds from line of credit and long-term borrowings	26,644	28,720	—
Principal payments on line of credit and long-term debt	(19,857)	(30,929)	(16,912)
Proceeds from sale of Iteris common and preferred stock	—	8,697	871

Proceeds from issuance of common stock	16,996	—	2,766
Net cash provided by (used in) financing activities	23,783	6,488	(13,275)
Increase (decrease) in cash	(2,662)	(1,810)	29
Cash and cash equivalents at beginning of year	4,880	2,218	408
Cash and cash equivalents at end of year	\$ 2,218	\$ 408	\$ 437

See accompanying notes.

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Odetics, Inc. and Subsidiary

Notes to Consolidated Financial Statements

March 31, 2003

1. Formation and Operations

Odetics, Inc. (the Company) provides products, systems and services that control and manage the use of public roadways and services access and safety of public and private facilities. Odetics currently operates through its wholly-owned subsidiaries, MAXxess Systems, Inc., formally known as Gyyr Incorporated (MAXxess), and its majority-owned subsidiary, Iteris, Inc. (Iteris).

During fiscal 2002 and fiscal 2003, the Company incurred net losses of \$26.6 million and \$13.1 million, respectively. The Company financed its operations in fiscal 2002 and fiscal 2003 largely through cash received from debt and equity financings, the sale of assets and the divestiture of certain of its subsidiaries.

On May 28, 2002, the Company completed the sale and leaseback of its Anaheim, California facility for an aggregate sale price of \$22.6 million. Under the terms of the sale and leaseback agreement, the Company will continue to lease one of the two buildings located on the property for an initial ten-year period at a rate of \$152,150 per month and the other building for a period of 30 months at a rate of approximately \$57,553 per month. Approximately \$16.4 million of the proceeds from the sale was used to repay the outstanding indebtedness and accrued interest under a promissory note that was secured by a first deed of trust on the Anaheim facility (Note 6), and \$2.5 million is being held in escrow as a security deposit on future lease payments. The balance of the proceeds was available for general working capital purposes. The gain on the sale of the facility was approximately \$8.2 million, of which \$640,000 was recognized immediately, and the remainder was deferred and is being amortized against rent expenses over the term of the leases.

On August 16, 2002, the Company completed a private placement of 2,500,000 of our Class A common stock to an institutional investor for \$3.0 million in cash. The transaction, net of expenses, raised net proceeds of approximately \$2.7 million. In connection with this offering, the Company also issued warrants to the investor to purchase up to another 1,250,000 shares at an exercise price of \$1.50 per share, and up to 1,250,000 shares at an exercise price of \$1.80 per share. The warrants are exercisable at any time by the investor, and are callable by us if the market price of the Company's Class A common stock trades for 20 consecutive days at a price equal or greater than two times the exercise price of the warrants. If all of the warrants are exercised, the total gross proceeds from this transaction are expected to be \$7.2 million. The proceeds from the transaction were used to fund general working capital requirements.

On May 9, 2003, the Company completed the sale of substantially all of the assets of its Zyfer subsidiary for \$2.3 million in cash plus the assumption of certain liabilities. The asset purchase agreement provides for future incentive payments of up to \$1 million in each of the twelve month periods ended April 30, 2004 and 2005, based on the achievement of certain revenue goals related to the sale of Zyfer products or the licensing of its technologies.

The Company expects that its operations will continue to use net cash at least through the end of calendar 2003. The Company also expects to have an ongoing need to raise cash by securing additional debt or equity financing, or by divesting certain assets to fund its operations until the Company returns to profitability and positive operating cash flows. The Company believes that its future ability to obtain additional funding will be dependent upon its ability to narrow our operating losses and provide a favorable expectation of future operating profitability. The Company believes its ability to raise additional capital may also be adversely affected if Nasdaq determines to delist the Company's Class A common stock from the Nasdaq SmallCap Market. The steps undertaken in fiscal 2002 and fiscal 2003

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were intended to lower its operating costs, widen its gross profits, and generally provide more opportunity to return to profitability. Furthermore, the Company believes that a focused business model provides a more compelling opportunity for appreciation in stockholder value. Notwithstanding the recent refinements to our business model and its more defined focus, the Company cannot be certain that it will be able to secure additional debt or equity financing on acceptable terms, on a timely basis, or at all.

The Company's future cash requirements will be highly dependent upon its ability to control expenses, as well as the successful execution of the revenue plans by both Iteris and MAXxess. A critical element of controlling expenses relates to the restructuring of the Company's facilities lease arrangements. Management is currently in negotiations with the Company's landlords to restructure its leases for its principal facilities in order to reduce the Company's overall operating expenses to a level commensurate with its existing operations. The outcome of these negotiations cannot be assured and, as a result, any projections of future cash requirements and cash flows are subject to substantial uncertainty.

These conditions, together with the Company's recurring losses, raise substantial doubt about its ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or liabilities that may result from the outcome of this uncertainty.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates made in preparing the consolidated financial statements include the allowances for doubtful accounts deferred tax assets, inventory reserves, certain accrued liabilities, costs to complete long-term contracts and estimates of future cash flows used to determine the recoverability of long lived assets.

Revenue Recognition

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

Contract revenues are derived primarily from long-term contracts with governmental agencies. Contract revenue includes 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

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and final contract settlements may result in revisions to cost and revenue and are recognized in the period in which the revisions are determined. Profit incentives are included in revenue when their realization is reasonably assured.

Revenues from follow-on service and support, for which the Company charges separately, is recorded in the period in which the services are performed.

Cash and Cash Equivalents

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

Concentration of Credit Risk

The Company maintains reserves for potential credit losses, estimating the collectibility of customer receivables on an ongoing basis by periodically reviewing invoices outstanding over a certain period of time. The Company has recorded reserves for receivables deemed to be at risk for collection, as well as a general reserve based on historical collections experience. A considerable amount of judgment is required in assessing the ultimate realization of these receivables, including the current credit-worthiness of each customer. Such losses have been minimal and within management's estimates. Receivables from customers are generally unsecured. At March 31, 2002 and 2003, accounts receivable from governmental agencies and prime government contractors were approximately \$3,575,000 and \$3,362,000, respectively.

Fair Values of Financial Instruments

Fair values of cash and cash equivalents approximate the carrying value because of the short period of time to maturity. The fair value of line of credit agreements approximate carrying value because the related rates of interest approximate current market rates.

Inventories

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

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Equipment is depreciated principally by the declining balance method over their

estimated useful lives ranging from four to eight years. Depreciation expense from continuing operations for the years ended March 31, 2001, 2002 and 2003 was \$1.1 million, \$1.1 million and \$0.8 million, respectively.

Long-Lived Assets

Long-lived assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company believes no impairment of the carrying value of its long-lived assets existed at March 31, 2003. The Company's analysis was based on an estimate of future undiscounted cash flows using forecasts contained in the Company strategic plan. It is at least reasonably possible that the Company's estimate of future undiscounted cash flows may change during fiscal 2004. If the Company's estimate of

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future undiscounted cash flow should change or if the strategic plan is not achieved, future analyses may indicate insufficient future undiscounted cash flows to recover the carrying value of the Company's long-lived assets, in which case such assets would be written down to estimated fair value.

Goodwill

Goodwill, representing the excess of the purchase price over the fair value of the net assets of acquired entities. At March 31, 2003, all goodwill is attributable to the Company's Intelligent Transportation segment.

On April 1, 2002, the Company adopted Financial Accounting Standards Board (FASB) Statement No. 142, *Goodwill and Other Intangible Assets* (Statement 142). Under Statement 142, goodwill is no longer amortized but is subject to impairment tests based upon a comparison of the fair value of each of the Company's reporting units, as defined, and the carrying value of the reporting units' net assets, including goodwill. Pursuant to Statement 142, upon adoption the Company tested its goodwill for impairment and, based upon recent sales of equity securities, determined that no impairment existed. Statement 142 requires a review for impairment at least annually or when circumstances exist that would indicate an impairment of such goodwill. The Company performs the annual impairment review as of January 1 of each year. The 2003 annual review resulted in no impairment of the carrying value of goodwill. Adjusted net income and the related earnings per share impact of the adoption of Statement 142 is as follows:

	Year ended March 31,		
	2001	2002	2003
Reported income (loss) from continuing operations	\$ 1,471	\$ (5,173)	\$ (4,394)
Add back goodwill amortization	1,924	1,516	—
Adjusted net income (loss) from continuing operations	3,395	(3,657)	(4,394)
Loss from discontinued operations, net of income taxes	(34,011)	(20,965)	(8,754)
Extraordinary loss on early extinguishment of debt	—	(450)	—
Adjusted net income (loss)	\$ (30,616)	\$ (25,072)	\$ (13,148)
Basic earnings (loss) per share:			
Reported income (loss) from continuing operations	\$ 0.15	\$ (0.46)	\$ (0.31)
Add back goodwill amortization	0.19	0.13	—
Adjusted net income (loss) from continuing operations	0.34	(0.33)	(0.31)
Loss from discontinued operations, net of income taxes	(3.41)	(1.86)	(0.61)
Extraordinary loss on early extinguishment of debt	—	(0.04)	—
Adjusted net income (loss)	\$ (3.07)	\$ (2.23)	\$ (0.92)
Diluted earnings (loss) per share:			
Reported income (loss) from continuing operations	\$ 0.14	\$ (0.46)	\$ (0.31)
Add back goodwill amortization	0.19	0.13	—
Adjusted net income (loss) from continuing operations	0.33	(0.33)	(0.31)
Loss from discontinued operations, net of income taxes	(3.33)	(1.86)	(0.61)
Extraordinary loss on early extinguishment of debt	—	(0.04)	—

Adjusted net income (loss)

\$ (3.00) \$ (2.23) \$ **(0.92)**

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Research and Development Expenditures

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

Warranty

Unless otherwise stated, the Company provides a one-year warranty from the original invoice date on all product material and workmanship. Products sold to certain original equipment manufacturer customers sometimes carry longer warranties. Defective products will be either repaired or replaced, generally at the Company's option, upon meeting certain criteria. The Company accrues 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 activity in accrued warranty obligations is as follows:

	March 31,		
	2001	2002	2003
	(in thousands)		
Balance at beginning of year	\$ 321	\$ 209	\$ 274
Additions charged to cost of sales	95	153	323
Warranty claims	(207)	(88)	(316)
	\$ 209	\$ 274	\$ 281

Foreign Currency Translation

The balance sheet accounts of the Company's foreign based subsidiaries are translated at the current year-end exchange rate and income statement items are translated at the average exchange rate for the year. Resulting translation adjustments are made directly to a separate component of stockholders' equity. Gains and losses resulting from transactions of the Company and its subsidiaries which are made in currencies different from their own are immaterial and are included in income as they occur.

Comprehensive Income

The only component of accumulated other comprehensive income is the cumulative foreign currency translation adjustment recorded in stockholders' equity.

Income Taxes

Deferred income tax assets and liabilities are computed for differences between financial statement and tax basis of assets and liabilities based on enacted tax laws and rates applicable to the period in which differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not to be realized. The provision for income taxes is the taxes payable or refundable for the period plus or minus the change during the period in deferred income tax assets and liabilities.

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Earnings (Loss) Per Share

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

	Year ended March 31,		
	2001	2002	2003
Numerator:			
Net loss	\$ (32,540)	\$ (26,588)	\$ (13,148)
Denominator:			
Denominator for basic loss per share—weighted-average shares	9,977	11,267	14,276
Effect of dilutive securities:			

Employee stock options	232	—	—
Denominator for diluted loss per share	10,209	11,267	14,276
Basic loss per share	\$ (3.26)	\$ (2.36)	\$ (0.92)
Diluted loss per share	\$ (3.19)	\$ (2.36)	\$ (0.92)

Stock-Based Compensation

The Company accounts for stock-based employee compensation arrangements in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock-Issued to Employees* (APB No. 25) and related interpretations, and complies with the disclosure provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation* (Statement 123). Under APB No. 25, compensation cost is recognized based on the difference, if any, on the date of the grant between the fair value of the Company's stock and the amount the employee must pay to acquire the stock.

In December 2002, the FASB issued Statement No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, (Statement 148) providing alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, Statement 148 amends the disclosure requirements to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company does not currently plan to change its stock-based employee compensation accounting to the fair value method. The accompanying financial statements reflect all of the disclosures required by Statement 148.

In calculating pro forma information regarding net income and earning per share, as required by Statement No. 123, the fair value was estimated at the date of grant using a Black-Scholes option pricing model with the following assumption:

	Years ended March 31,		
	2001	2002	2003
Dividend rate	0.0	0.0	0.0
Expected life—years	7.0	7.0	7.0
Risk-free interest rate	6.0	4.5	2.0
Volatility of common stock	0.4	0.4	0.4

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For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information for the year ended March 31, 2001, 2002 and 2003 follows (in thousands, except per share data):

	Year ended March 31,		
	2001	2002	2003
	(In thousands except per share amounts)		
Net loss—reported	\$ (32,540)	\$ (26,588)	\$ (13,148)
Employee compensation expense under fair value method	(972)	(201)	(637)
Net loss—pro forma	\$ (33,512)	\$ (26,789)	\$ (13,785)
Basic loss per share—reported	\$ (3.26)	\$ (2.36)	\$ (0.92)
Basic loss per share—pro forma	\$ (3.36)	\$ (2.38)	\$ (0.97)
Diluted loss per share—reported	\$ (3.19)	\$ (2.36)	\$ (0.92)
Diluted loss per share—pro forma	\$ (3.28)	\$ (2.38)	\$ (0.97)

Advertising Expenses

The Company expenses advertising costs as incurred. Advertising expense totaled \$1,211,000, \$420,000 and \$544,000 in the years ended March 31, 2001, 2002 and 2003, respectively.

Discontinued Operations

In August 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). The Statement supersedes FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, however, it retains the fundamental provisions of that statement related to the recognition and measurement of the impairment of long-lived assets to be "held and used." SFAS 144 also supersedes the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, *Reporting the Results*

of Operation's—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions (APB 30), for the disposal of a segment of a business. Under SFAS 144, a component of a business that is held for sale is reported in discontinued operations if (i) the operations and cash flows will be, or have been, eliminated from the ongoing operations of the company and, (ii) the company will not have any significant continuing involvement in such operations. In the quarter ended September 30, 2001, the Company adopted the provisions of SFAS 144 effective April 1, 2001.

In September 2001, the Company's Board of Directors approved a plan to discontinue the operations of Mariner which was part of the Company's telecom products segment. The aggregate losses recognized to write down the assets of Mariner to their fair value less cost to sell were approximately \$6.7 million. In addition, the Company accrued \$1.7 million for severance and other direct costs to exit the operation.

In March 2003, the Company decided to divest of its Zyfer, Inc. subsidiary (Zyfer). On May 9, 2003, the Company completed the sale of substantially all of the net assets of Zyfer, with a net book

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value of approximately \$2.3 million, for \$2.3 million. The Company may also receive incentive payments of up to \$2 million should Zyfer meet certain revenue targets in the twelve month periods ended April 30, 2004 and 2005. The initial purchase price is subject to adjustment within 45 days of the closing in the event that the assets purchased less the liabilities assumed by the buyer is less than \$2.2 million. In connection with the Zyfer sale, the Company accrued \$1.1 million for certain future lease obligations of Zyfer that were not transferred to the buyer.

In March 2003, the Company ceased the development and sale of products in its Broadcast, Inc. subsidiary (Broadcast) and reduced the headcount in Broadcast to only support the existing customer contracts for service and support through their expiration dates. The aggregate losses recognized to write down the assets of Broadcast to their fair value less cost to sell were approximately \$3.4 million. In addition, the Company accrued \$0.4 million for employees severed in March 2003 and other direct costs to wind down the operation.

The asset write-downs and accrued costs are included in the loss from discontinued operations in the year ending March 31, 2003. The results of operations of Mariner, Zyfer and Broadcast for all periods presented have been reclassified and presented as discontinued operations in the accompanying consolidated statement of operations. Interest expense was not reclassified to discontinued operations because the discontinuances did not eliminate any of the Company's debt.

The net sales and loss from discontinued operations are as follows:

	Year ended March 31,		
	2001	2002	2003
Net sales:			
Zyfer	\$ 4,464	\$ 4,475	\$ 6,487
Broadcast	9,292	2,824	3,599
Mariner	910	533	—
Total net sales	\$ 14,666	\$ 7,832	\$ 10,086
Loss from discontinued operations:			
Zyfer	\$ (5,284)	\$ (5,100)	\$ (1,718)
Broadcast	(16,822)	(2,941)	(2,468)
Mariner	(11,905)	(4,563)	—
Total loss from discontinued operations	(34,011)	(12,604)	(4,186)
Loss recognized upon discontinuance of operations	—	(8,361)	(4,909)
Gain on sale of assets of discontinued operations	—	—	341
	\$ (34,011)	\$ (20,965)	\$ (8,754)

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The assets and liabilities of the discontinued operations consisted of the following:

	March 31,	
	2002	2003

Accounts receivable	\$ 1,684	\$ 1,632
Inventories	4,704	1,892
Prepaid expenses & other assets	211	125
Property, plant and equipment, net	1,926	743
	<hr/>	<hr/>
Total assets of discontinued operations	\$ 8,525	\$ 4,392
	<hr/>	<hr/>
Accounts payable	\$ 3,223	\$ 2,250
Accrued expenses	1,362	1,889
	<hr/>	<hr/>
Total liabilities of discontinued operations	\$ 4,585	\$ 4,139
	<hr/>	<hr/>

Recent Accounting Pronouncements

In 2003, the Company adopted Statement of Financial Accounting Standards No. 141, *Business Combinations* (SFAS 141). SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. Application of this statement did not have a significant effect on the Company's consolidated results of operations or financial position.

In July 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (Statement 146). Statement 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)* (EITF 94-3). Statement 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. The Company adopted Statement 146 on January 1, 2003.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45), effective prospectively for guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for periods ending after December 15, 2002. Under FIN 45, a guarantor is required to recognize, at the inception of certain guarantees, a fair value liability for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. All guarantees subject to the disclosure provisions of FIN 45, such as product warranties, have been disclosed in the accompanying notes to the consolidated financial statements. The Company does not have any other outstanding guarantees at March 31, 2003 required to be disclosed or recorded as obligations upon adoption of FIN 45.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). This Interpretation changes the method of determining whether certain entities should be included in the Company's Consolidated Financial Statements. An entity is subject to FIN 46 and is called a variable interest entity (VIE) if it has (1) equity that is insufficient to permit the entity to

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finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make significant decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the entity. All other entities are evaluated for consolidation under SFAS No. 94, *Consolidation of All Majority-Owned Subsidiaries*. The provisions of FIN 46 are to be applied immediately to VIEs created after January 31, 2003, and to VIEs in which an enterprise obtains an interest after that date. For VIEs in which an enterprise holds a variable interest that it acquired before February 1, 2003, FIN 46 applies in the first fiscal period beginning after June 15, 2003. The Company has not yet determined the impact, if any, that the adoption of FIN 46 will have on the Company's financial position, results of operations or cash flows.

Reclassifications

Certain amounts in the fiscal 2001 and fiscal 2002 consolidated financial statements have been reclassified to conform with the 2003 presentation.

3. Acquisitions and Dispositions

In October 1998, the Company, through Iteris, acquired Meyer, Mohaddes Associates, Inc., a provider of transportation, engineering and planning services (MMA). Pursuant to the terms of the merger agreement, the Company purchased all of the issued and outstanding shares of stock of MMA for \$4.3 million, by issuing 55,245 shares of the Company's Class A common stock valued at \$250,000 and 810,153 shares of Iteris, Inc.'s common stock.

The merger agreement provided for MMA shareholders to receive additional shares of the Company's Class A common stock with a then market value of \$250,000 at each of April 16, 1999, October 16, 1999, April 16, 2000, October 16, 2000 and April 16, 2001 in the event the Company did not consummate an initial public offering of the common stock of Iteris, Inc. by each and any of those dates. Pursuant to this provision, Odetics issued an additional 219,706 shares of its Class A common stock to the MMA shareholders, which was recorded by

the Company as additional goodwill. In addition, as a result of Iteris' failure to complete an initial public offering by October 2001, the MMA shareholder exercised their rights under the agreement and required Odetics to exchange 1,107,301 shares of Odetics' Class A common stock for 155,149 shares of Iteris common stock. This transaction resulted in additional goodwill of \$2.5 million.

During fiscal 2001, the Company sold certain assets of its sold state recording product line of its Zyfer subsidiary for cash proceeds of \$1.9 million. In connection with these sales the Company recorded gains aggregating \$1.2 million.

In April 2001, the Company sold its Vortex Dome and Quarterback Controller product lines for approximately \$1.1 million in net cash proceeds. In connection with this transaction, the Company realized a gain of \$0.1 million.

In September 2001, the Company sold substantially all of the assets of its Gyr CCTV Products line for \$8.8 million in cash, plus the assumption of \$1.0 million in debt. In connection with this transaction, the Company wrote-off goodwill with a net book value of \$2.3 million and, net of this write-off, realized a gain of \$4.3 million.

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4. Restructuring Charges

During fiscal 2001 and 2002, the Company approved a number of actions to reduce operating expenses and improve profitability and cash flows. These actions included a reduction in workforce of 222 and 130 employees in 2001 and 2002 respectively. As a result of these actions, the Company recorded the following as restructuring charges (in thousands):

	Severance and related costs	
	\$	
2001 restructuring charge	\$	757
Cash expenditures		(757)
Balance at March 31, 2001		—
2002 restructuring charge		2,189
Cash expenditures		(858)
Balance at March 31, 2002		1,331
Cash expenditures		(911)
Balance at March 31, 2003	\$	420

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5. Costs and Estimated Earnings on Uncompleted Contracts

Costs incurred, estimated earnings and billings on uncompleted long-term contracts are as follows:

	March 31,	
	2002	2003
	(In thousands)	
Costs incurred on uncompleted contracts	\$ 17,998	\$ 15,645
Estimated earnings	1,355	1,173
	19,353	16,818
Less billings to date	18,024	14,724
	\$ 1,329	\$ 2,094
Included in accompanying balance sheets:		
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 3,565	\$ 2,398
Billings in excess of costs and estimated earnings on uncompleted contracts	2,236	(304)
	\$ 1,329	\$ 2,094

Costs and estimated earnings in excess of billings at March 31, 2002 and 2003 include \$136,114 and \$244,172 respectively, that were not billable as certain milestone objectives specified in the contracts had not been attained. Substantially all costs and estimated earnings in excess of billings at March 31, 2002 are expected to be billed and collected during the year ending March 31, 2003.

6. Revolving Lines of Credit and Long-Term Debt

In February 2002, the Company entered into a \$1.25 million line of credit with a partnership controlled by the Company's Chairman of the Board. The line of credit is collateralized by substantially all of the Company's assets other than real property. Borrowings on the line of credit bear interest at the prime rate plus 4% (8.25% at March 31, 2003) and matures in April 2004.

Borrowings on the line of credit totaled \$1.25 million at March 31, 2002 and 2003. Interest expense under the line of credit totaled \$8,000 and \$110,000 in the years ended March 31, 2002 and 2003.

In October 2002, the Company entered into a receivables purchase agreement with a partnership controlled by the Company's Chairman of the Board to sell certain receivables. Under certain conditions of the agreement the Company may be required to buy back any uncollected receivables. The total amount transferred under the agreement was \$1.2 million with \$0.4 million uncollected as of March 31, 2003. The total fees and interest expense under the agreement was \$0.1 million during the year ended March 31, 2003.

In August 2001, the Company through Iteris, entered into a loan and security agreement with a maximum available credit line of \$5.0 million. At March 31, 2002, there were no outstanding borrowings under this line of credit and amounts available for future borrowing totalled \$4.1 million. Under the terms of the agreement, the Company may borrow against its eligible accounts receivable and the value of its eligible inventory, as defined. Interest on borrowed amounts is payable monthly at the prime rate plus 2% (6.25% at March 31, 2003). Additionally, Iteris is obligated to pay an unused line fee of 0.5% per annum applied to the amount by which the maximum credit amount exceeds the average daily principal balance during the preceding month, and a monthly collateral management fee of \$2,000. The agreement is secured by substantially all of Iteris' assets and expires in August 2004. Either party can terminate the agreement with thirty days written notice. Should Iteris elect to

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terminate the agreement, a one-time termination fee of 3%, 2% and 1% of the maximum credit limit would apply in years 1 through 3, respectively.

In January 2000, the Company through Iteris, entered into a joint venture agreement, pursuant to which Iteris obtained a Subordinated Convertible Promissory Note in the amount of \$3.75 million. In July 2001, the note holder converted the note and related accrued interest into common and preferred stock of Iteris (Note 11).

In May 2001, the Company entered into a \$16 million promissory note secured by a first trust deed on its principal facilities in Anaheim, California, which bore interest at 10% per annum. The promissory note was paid in full at its scheduled maturity date in May 2002 (Note 1). In connection with the note the Company issued warrants to the lender to purchase 426,667 shares of Class A common stock at an exercise price of \$4.00 per share. The Company repriced the warrants to \$3.00 per share, in connection with a forbearance agreement negotiated in November 2001. The issuance of the warrant represented a discount on the note totaling \$1,357,000, which was amortized over the life of the note.

Approximately \$6.0 million of the proceeds of the promissory note was used to retire the pre-existing note payable on the Anaheim facility, which included a prepayment penalty of \$450,000. This prepayment penalty is reflected as an extraordinary item in the accompanying consolidated statement of operations.

Long-term debt consisted of the following:

	March 31,	
	2002	2003
	(In thousands)	
Note payable, net of discount of \$244,000 at March 31, 2002, paid in May 2002	\$ 15,756	\$ —
Notes payable, accruing interest at 7.55% to 17.08%, collateralized by equipment, payable in monthly installments through fiscal 2003	402	—
	16,158	—
Less current portion	16,133	—
	\$ 25	\$ —

7. Income Taxes

The reconciliation of the income tax benefit from continuing operations to taxes computed at U.S. federal statutory rates is as follows:

	Year ended March 31,		
	2001	2002	2003
	(In thousands)		
Income tax benefit at statutory rates	\$ 500	\$ (1,376)	\$ (196)
State income taxes net of federal benefit	—	—	4
Increase in valuation allowance associated with federal deferred tax assets	(2,138)	(208)	(273)
Foreign losses recorded without benefit	1,185	347	310
Nondeductible goodwill amortization	153	176	—
Other	303	276	155
	\$ —	\$ (785)	\$ —

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United States and foreign income (loss) from continuing operations before income taxes are as follows:

	Year ended March 31,		
	2001	2002	2003
	(In thousands)		
Pretax income (loss):			
Domestic	\$ 4,960	\$ (3,603)	\$ (182)
Foreign	(3,489)	(1,021)	(394)
	\$ 1,471	\$ (4,048)	\$ (576)

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

	March 31,	
	2002	2003
	(In thousands)	
Deferred tax assets:		
Net operating losses	\$ 21,267	\$ 19,289
Book over tax depreciation	—	6,025
Credit carryforwards	1,503	1,999
Deferred compensation and payroll	1,192	1,231
Bad debt allowances and other reserves	357	265
Other, net	1,121	406
Total deferred tax assets	25,440	29,215
Valuation allowance	(23,557)	(28,748)
Net deferred tax assets	1,883	467
Deferred tax liabilities:		
Tax over book depreciation	(1,416)	—
Capitalized interest and taxes	(421)	(421)
Other, net	(46)	(46)
Total deferred tax liabilities	(1,883)	(467)

At March 31, 2003, the Company had approximately \$1,299,000 in federal general business credit carryforwards that begin to expire in 2006 and \$700,000 in state general business credit carryforwards that can be carried forward indefinitely. The Company had \$48,231,000 of federal net operating loss carryforwards that begin to expire in 2019 and \$31,000,000 of state net operating loss carryforwards that begin to expire in 2003. For financial reporting purposes, a valuation allowance has been recorded to offset the deferred tax asset related to these credits and net operating losses. Any future benefits recognized from the reduction of the valuation allowance related to these carryforwards will result in a reduction of income tax expense.

In December 2001, the Company's ownership interest in Iteris fell below the threshold required for the Company to file a consolidated tax return. As a result, Iteris will no longer be included in the Odetics consolidated group for income tax purposes, and instead will be required to file a separate tax return. At March 31, 2003, for federal income tax purposes, Iteris had approximately \$583,000 of the net operating loss carryforwards described above. Iteris's portion of the net operating losses begins to expire in 2021.

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On September 11, 2003, the Governor of California signed into law new tax legislation that suspends the use of net operating loss carryforward into tax years beginning on or after January 1, 2002 and 2003. Should the Company have taxable income for the year ending March 31, 2003 and 2004, it may not look to California net operating losses generated in prior years to offset taxable income. This suspension will not apply to tax years beginning in 2004 and beyond.

Because of the "change of ownership" provision of the Tax Reform Act of 1986, utilization of the Company's net operating loss carryforwards may be subject to an annual limitation against taxable income in future periods. As a result of the annual limitation, a portion of these carryforwards may expire before ultimately becoming available to reduce future income tax liabilities.

8. Associate Incentive Programs

Under the terms of a Profit Sharing Plan, the Company contributes to a trust fund such amounts as are determined annually by the Board of Directors. No contributions were made in 2001, 2002 or 2003.

In May 1990, the Company adopted a 401(k) Plan as an amendment and replacement of the former Associate Stock Purchase Plan that was an additional feature of the Profit Sharing Plan. Under the 401(k) Plan, eligible associates voluntarily contribute to the plan up to 15% of their salary through payroll deductions. The Company matches 50% of contributions up to a stated limit. Under the provisions of the 401(k) Plan, associates have four investment choices, one of which is the purchase of Odetics, Class A common stock at market price. Company matching contributions were approximately \$812,000, \$722,000 and \$544,000 in 2001, 2002 and 2003, respectively.

9. Deferred Compensation Plans

During 1986, the Company adopted an Executive Deferral Plan under which certain executives may defer a portion of their annual compensation. All deferred amounts earn interest, generally with no guaranteed rate of return. Compensation charged to operations and deferred under the plan totaled \$128,000, \$66,000, and \$43,000 for 2001, 2002 and 2003, respectively.

10. Iteris Preferred and Common Stock

In July 2001, Iteris issued 1,781,268 shares of its Series A preferred stock (Iteris preferred stock) to an institutional investor in exchange for \$5.0 million in cash. In addition, Iteris issued 1,343,645 shares of its Iteris preferred stock and 547,893 shares of its common stock in exchange for \$500,000 in cash and the retirement of its \$3.75 million Subordinated Convertible Promissory Note plus related accrued interest of \$0.4 million.

Shares of Iteris preferred stock are convertible into shares of Iteris common stock at the conversion rate in effect at the time, as defined. Each share of Iteris preferred stock will automatically convert into shares of Iteris common stock immediately upon the closing of a firmly underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933 with aggregate gross proceeds to the Company of not less than \$30 million and price per share of not less than two times the original Iteris preferred stock issue price of \$2.80 per share.

In the event that the Company fails to consummate an initial public offering of Iteris common stock or complete a sale of Iteris to a third party with aggregate proceeds of \$25 million by January 1, 2004 and/or the holders of Iteris preferred stock elect not to exercise their rights to convert into common stock, the Company will be obligated to redeem the Iteris preferred stock at a sum equal to two times the original Iteris preferred stock issue price.

At March 31, 2002, the liquidation preference on Iteris preferred stock totals \$17.5 million. The difference between the initial issue price, net of related issuance costs, and the liquidation preference is

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being amortized over the redemption period and is reflected in minority interest in earnings of subsidiary in the accompanying consolidated statement of operations.

In August and December 2001, Odetics sold 1,539,241 shares of Iteris common stock that it held at an aggregate purchase price of \$3.8 million to a group of investors, which included certain members of management of Odetics and Iteris. In connection with this transaction, Odetics realized a loss of \$1.6 million which is reflected in other income (net) in the accompanying consolidated statement of operations.

In April 2002 and February 2003, the Company sold 322,581 shares of Iteris common stock that it held at an aggregate purchase price of \$0.9 million to a group of investors, which included certain members of management of Odetics and Iteris. In connection with this transaction, the Company realized a loss of \$0.3 million that is reflected in other income (net) in the accompanying consolidated statement of operations. In February 2003 Iteris purchased back from the Company 288,500 shares of Iteris common stock that the Company held. Odetics realized a loss of \$310,000 on this transaction, which is reflected in other income, net in the accompanying consolidated statement of operations. At March 31, 2003, the Company held 75.1% of the outstanding common stock of Iteris.

11. Stock Option Plans

The Company has adopted an Associate Stock Option Plan which provides that options for shares of the Company's unissued Class A common stock may be granted to directors and associates of the Company. Options granted enable the option holder to purchase one share of Class A common stock at prices which are equal to or greater than the fair market value of the shares at the date of grant. Options expire ten years after date of grant or 90 days after termination of employment and vest ratably at 33% on each of the first three anniversaries of the grant date.

A summary of all Company stock option activity is as follows:

	Year ended March 31,					
	2001		2002		2003	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
	(In thousands, except per share data)					
Options outstanding at beginning of year	801	\$ 7.68	804	\$ 8.44	329	\$ 8.37
Granted	120	13.47	30	2.28	659	1.38
Exercised	(24)	7.95	—	—	—	—
Cancelled	(93)	8.21	(505)	8.06	(26)	4.29
Options outstanding at end of year	804	\$ 8.44	329	\$ 8.37	962	\$ 3.73
Exercisable at end of year	531		237		879	
Available for grant at end of year	487		1,322		689	
Weighted average fair value of options granted		\$ 7.03		\$ 1.20		\$ 0.68

The exercise price for options outstanding as of March 31, 2003, ranged from \$1.02 to \$15.625. The weighted-average remaining contractual life of those options is 8.8 years.

Iteris, Inc.'s Stock Options

In September 1997, Iteris granted options to purchase up to 899,960 shares of its common stock to certain members of its senior management at an exercise price of \$1.07 per share. As of March 31, 2002, options to purchase 759,345 shares of common stock were outstanding.

Subsequently, Iteris' Board of Directors adopted and approved the 1998 Stock Incentive Plan (the Plan), as amended in February 2000, authorized 3,000,000 shares of Iteris' common stock for issuance under the Plan. Options to purchase 2,228,492 shares of common stock, at exercise prices ranging from \$1.60 to \$9.07 per share, were outstanding at March 31, 2002. Under the Plan, options expire ten years after date of grant or 90 days after termination of employment. The options granted vested ratably at 25% on each of the first four anniversaries of the grant date.

12. Commitments

The Company has lease commitments for facilities in various locations throughout the United States. The annual commitment under these noncancelable operating leases at March 31, 2003 is as follows:

Fiscal Year	(in thousands)
2004	\$ 2,171
2005	2,047
2006	1,928
2007	1,837
2008	1,826
Thereafter	7,608

Rent expense under operating leases totaled \$1,040,000, \$1,139,000 and \$2,597,000, respectively for the years ended March 31, 2001, 2002 and 2003.

Common stock reserved for future issuance at March 31, 2003:

Issuable under stock options plans	1,651,000
Issuable upon the exercise of warrants	2,926,667

13. Business Segment and Geographic Information

The Company operates in three reportable segments: intelligent transportation systems, video products, which includes products for the television broadcast and video security markets, and telecom products. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies except that certain expenses, such as interest, amortization of certain intangibles and certain corporate expenses are not allocated to the segments. In addition, certain assets including cash and cash equivalents, deferred taxes and certain long-lived and intangible assets are not allocated to the segments. Intersegment sales are recorded at the selling segment's cost plus profit.

The reportable segments are each managed separately because they manufacture and distribute distinct products or provide services with different processes.

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Selected financial information for the Company's reportable segments as of and for the years ended March 31, 2001, 2002 and 2003 follows:

	Intelligence Transportation	Video Products	Telecom Products	Total
	(In thousands)			
Year ended March 31, 2001				
Revenue from external customers	\$ 28,057	\$ 31,736	\$ 2,609	\$ 62,402
Depreciation and amortization	1,502	922	125	2,549
Segment income (loss)	(3,942)	(4,526)	1,120	(7,348)
Segment assets	18,709	15,438	375	34,522
Expenditure for long-lived assets	1,392	253	50	1,695
Year ended March 31, 2002				
Revenue from external customers	\$ 37,308	\$ 12,240	\$ 2,641	\$ 52,189
Depreciation and amortization	1,759	83	75	1,917
Segment income (loss)	2,979	(420)	1,316	3,875
Segment assets	25,736	1,519	250	27,505
Expenditure for long-lived assets, net	272	17	25	314
Year ended March 31, 2003				
Revenue from external customers	\$ 41,395	\$ 3,231	\$ 3,001	\$ 47,627
Depreciation and amortization	705	14	60	779
Segment income (loss)	2,459	(872)	1,706	3,293
Segment assets	26,005	806	—	26,811
Expenditure for long-lived assets, net	309	—	—	309

The following reconciles segment income to consolidated income before income taxes and segment assets and depreciation and amortization to consolidated assets and consolidated depreciation and amortization:

	March 31,		
	2001	2002	2003
	(In thousands)		
Segment Income (loss)			
Total income (loss) for reportable segments	\$ (7,348)	\$ 3,875	\$ 3,293
Other income	1,340	2,919	388
Unallocated amounts:			
Corporate and other expenses	(7,827)	(4,463)	(3,496)
Royalty income	17,825	—	—
Restructuring charges	(757)	(2,189)	—
Interest expense	(1,762)	(4,190)	(761)
Income (loss) from continuing operations before income taxes	\$ 1,471	\$ (4,048)	\$ (576)
Assets			
Total assets for reportable segments	\$ 34,522	\$ 27,505	\$ 26,811
Assets held at Corporate	33,539	24,733	8,031
Total assets	\$ 68,061	\$ 52,238	\$ 34,842
Depreciation and Amortization			
Depreciation and amortization for reportable segments	\$ 2,549	\$ 1,917	\$ 779
Other	2,418	1,859	37
Total depreciation and amortization	\$ 4,967	\$ 3,776	\$ 816

Selected financial information for the Company's continuing operations by geographic segment is as follows:

	March 31,		
	2001	2002	2003
	(In thousands)		
Geographic Area Revenue			
United States	\$ 55,968	\$ 50,376	\$ 46,716
Europe	6,434	1,813	911
Total net revenue	\$ 62,402	\$ 52,189	\$ 47,627
Geographic Area Long-Lived Assets			
United States	\$ 28,275	\$ 25,773	\$ 11,830
Europe	23	21	21
Total long-lived assets	\$ 28,298	\$ 25,794	\$ 11,851

14. Supplemental Cash Flow Information

	Year ended March 31,		
	2001	2002	2003

(In thousands)

Net cash used in changes in operating assets and liabilities, net of acquisitions:			
(Increase) decrease in accounts receivable	\$ (882)	\$ 3,897	\$ 68
(Increase) decrease in net costs and estimated earnings in excess of billings	1,259	(608)	(704)
(Increase) decrease in inventories	4,499	(1,542)	(556)
Increase in prepaids and other assets	861	(735)	1,051
Increase (decrease) in accounts payable and accrued expenses	(1,116)	(3,170)	1,348
Change in net operating assets of discontinued operations	—	(3,126)	(1,284)
Net cash used in changes in operating assets and liabilities	\$ 4,621	\$ (5,284)	\$ (77)
Cash paid (received) during the year:			
Interest	\$ 1,768	\$ 2,514	\$ 507
Income taxes paid (refunded)	86	—	—
Noncash transactions during the year:			
Proceeds from sale leaseback held in escrow	\$ —	\$ —	\$ 2,516
Contribution of common stock to 401(k) Plan	—	791	141
Exchange of note payable and accrued interest for Iteris stock	—	4,203	—
Stock issuance to former MMA shareholders	500	2,737	—
Issuance of common stock in settlement of accounts payable	—	390	—

15. Legal Proceedings

On October 11, 1999, the Company settled a patent infringement case it had brought against Storage Technology Corporation (StorageTek). Through an agreement, StorageTek agreed to pay the Company a license fee totaling \$100.0 million for use of the Company's United States Patent No. 4,779,151. Under the agreement, the license fee was payable in three installments: \$80.0 million upon signing of the agreement, and two annual installments of \$10.0 million payable in each of October 2000 and 2001. On June 12, 2000, the Company and StorageTek amended the agreement, whereby StorageTek agreed to pay a final discounted payment of \$17.8 million immediately in full settlement of the \$20.0 million otherwise due to complete the settlement, which is reflected in the accompanying consolidated financial statements as royalty income.

From time to time, the Company may be involved in litigation relating to claims arising out of its operations in the normal course of business. The Company currently is 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 its consolidated results of operations, financial position or cash flows.

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16. Supplementary Quarterly Consolidated Financial Data (Unaudited)

All quarters presented in the following schedule have been restated for the discontinuance of Mariner, Zyfer and Broadcast.

	Net Sales	Gross Profit	Loss from Continuing Operations	Net Loss	Loss per Share from Continuing Operations
June 30, 2001	\$ 14,268	4,819	(2,168)	(7,775)	\$ (0.21)
September 30, 2001(1)	14,609	5,900	(2,077)	(15,164)	(0.20)
December 31, 2001	11,435	4,893	(964)	(2,331)	(0.08)
March 31, 2002	11,877	6,676	36	(1,318)	(0.00)
June 30, 2002	11,945	5,124	(485)	(1,300)	(0.04)
September 30, 2002	11,168	4,575	(1,306)	(2,617)	(0.09)
December 31, 2002	12,452	5,496	(384)	(905)	(0.03)
March 31, 2003(2)	12,062	4,974	(2,219)	(8,326)	(0.16)

- (1) During the quarter ended September 30, 2001, the Company discontinued the operations of its Mariner subsidiary and restructured its European operations. In connection with these actions, the Company recorded severance and other charges and wrote down assets totaling \$9.9 million.
- (2) During the quarter ended March 31, 2003, the Company discontinued the operations of its Zyfer and Broadcast subsidiaries. In connection with those actions, the Company recorded severance payments and other charges and wrote down assets totaling \$4.9 million.

Schedule II

Valuation and Qualifying Accounts

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Accounts	Deductions Describe	Balance at End of Period
Year ended March 31, 2001					
Deducted from asset accounts:					
Allowance for doubtful accounts	\$ 990,000	\$ 78,000	\$ (502,000)	\$ —	\$ 1,644,000
Reserve for inventory obsolescence	1,184,000	4,925,000	(4,443,000)	—	3,968,000
Year ended March 31, 2002					
Deducted from asset accounts:					
Allowance for doubtful accounts	\$ 600,000	\$ —	\$ (485,000)	\$ —	\$ 115,000
Reserve for inventory obsolescence	2,048,000	65,000	(1,735,000)	—	378,000
Year ended March 31, 2003					
Deducted from asset accounts:					
Allowance for doubtful accounts	\$ 115,000	\$ 78,000	\$ (37,000)	\$ —	\$ 156,000
Reserve for inventory obsolescence	378,000	—	(130,000)	—	248,000

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ODETICS, INC.
1997 STOCK INCENTIVE PLAN
(Amended and Restated as of May 3, 2002)

ARTICLE ONE
GENERAL PROVISIONS

I. PURPOSE OF THE PLAN

This 1997 Stock Incentive Plan is intended to promote the interests of Odetics, Inc., a Delaware corporation, by providing eligible persons with the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in the Corporation as an incentive for them to remain in the service of the Corporation.

Capitalized terms shall have the meanings assigned to such terms in the attached Appendix.

II. STRUCTURE OF THE PLAN

A. The Plan shall be divided into three separate equity programs:

- The Discretionary Option Grant Program under which eligible person may, at the discretion of the Plan Administrator, be granted options to purchase shares of Class A Common Stock,
- the Stock Issuance Program under which eligible persons may, at the discretion of the Plan Administrator, be issued shares of Class A Common Stock directly, either through the immediate purchase of such shares or as a bonus for services rendered the Corporation (or any Parent or Subsidiary), and
- the Automatic Option Grant Program under which eligible non-employee Board members shall automatically receive option grants at periodic intervals to purchase shares of Class A Common Stock.

B. The provisions of Articles One and Five shall apply to all equity programs under the Plan and shall govern the interests of all persons under the Plan.

III. ADMINISTRATION OF THE PLAN

A. The Primary Committee shall have sole and exclusive authority to administer the Discretionary Option Grant and Stock Issuance Programs with respect to Section 16 Insiders. Administration of the Discretionary Option Grant and Stock Issuance Programs with respect to all other persons eligible to participate in those programs may, at the Board's discretion, be vested in the Primary Committee or a Secondary Committee, or the Board may retain the power to administer those programs with respect to all such persons.

B. Members of the Primary Committee or any Secondary Committee shall serve for such period of time as the Board may determine and may be removed by the Board at any time. The Board may also at any time terminate the functions of any Secondary Committee and reassume all powers and authority previously delegated to such committee.

C. Each Plan Administrator shall, within the scope of its administrative functions under the Plan, have full power and authority (subject to the provisions of the Plan) to establish such rules and regulations as it may deem appropriate for proper administration of the Discretionary Option Grant and Stock Issuance Programs and to make such determinations under, and issue such interpretations of, the provisions of such programs and any outstanding options or stock issuances thereunder as it may deem necessary or advisable. Decisions of the Plan Administrator within the scope of its administrative functions under the Plan shall be final and binding on all parties who have an interest in the

Discretionary Option Grant and Stock Issuance Programs under its jurisdiction or any option or stock issuance thereunder.

D. Service on the Primary Committee or the Secondary Committee shall constitute service as a Board member, and members of each such committee shall accordingly be entitled to full indemnification and reimbursement as Board members for their service on such committee. No member of the Primary Committee or the Secondary Committee shall be liable for any act or omission made in good faith with respect to the Plan or any option grants or stock issuances under the Plan.

E. Administration of the Automatic Option Grant Program shall be self-executing in accordance with the terms of that program, and no Plan Administrator shall exercise any discretionary functions with respect to any option grants or stock issuances made under such program.

IV. ELIGIBILITY

A. The persons eligible to participate in the Discretionary Option Grant and Stock Issuance Programs are as follows:

- (i) employees,
- (ii) non-employee members of the Board or the board of directors of any Parent or Subsidiary, and
- (iii) consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. Each Plan Administrator shall, within the scope of its administrative jurisdiction under the Plan, have full authority to determine, (i) with respect to the option grants under the Discretionary Option Grant Program, which eligible persons are to receive option grants, the time or times when such option grants are to be made, the number of shares to be covered by each such grant, the status of the granted option as either an Incentive Option or a Nonstatutory Option, the time or times when each option is to become exercisable, the vesting schedule (if any) applicable to the option shares and the maximum term for which the option is to remain outstanding and (ii) with respect to stock issuances under the Stock Issuance Program, which eligible persons are to receive stock issuances, the time or times when such issuances are to be made, the number of shares to be issued to each Participant, the vesting schedule (if any) applicable to the issued shares and the consideration to be paid for such shares.

C. The Plan Administrator shall have the absolute discretion either to grant options in accordance with the Discretionary Option Grant Program or to effect stock issuances in accordance with the Stock Issuance Program.

D. The individuals who shall be eligible to participate in the Automatic Option Grant Program shall be limited to (i) those individuals serving as non-employee Board members on the Plan Effective Date, (ii) those individuals who first become non-employee Board members on or after the Plan Effective Date, whether through appointment by the Board or election by the Corporation's stockholders, and (iii) those individuals who continue to serve as non-employee Board members at one or more Annual Stockholders Meetings held after the Plan Effective Date.

V. STOCK SUBJECT TO THE PLAN

A. The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Class A Common Stock, including shares repurchased by the Corporation on the open market. The maximum number of shares of Class A Common Stock reserved for issuance over the term of the Plan shall not exceed 1,805,000 shares. This reserve includes (i) the 530,000 shares originally reserved for issuance under the Plan, (ii) the 400,000 share increase approved by the Corporation's stockholders at

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the 1999 Annual Meeting, (iii) the 400,000 share increase approved by the Corporation's stockholders at the 2000 Annual Meeting, and (iv) the 475,000 share increase approved by the Corporation's stockholders at the 2001 Annual Meeting.

B. No one person participating in the Plan may receive options, separately exercisable stock appreciation rights and direct stock issuances for more than 80,000 shares of Class A Common Stock in the aggregate per calendar year, beginning with the 1997 calendar year.

C. Shares of Class A Common Stock subject to outstanding options shall be available for subsequent issuance under the Plan to the extent (i) those options expire or terminate for any reason prior to exercise in full or (ii) those options are cancelled in accordance with the option cancellation/regrant provisions of Section IV of Article Two. Unvested shares issued under the Plan and subsequently cancelled or repurchased by the Corporation, at the original exercise or direct issue price paid per share, pursuant to the Corporation's repurchase rights under the Plan shall be added back to the number of shares of Class A Common Stock reserved for issuance under the Plan and shall accordingly be available for reissuance through one or more subsequent option grants or direct stock issuances under the Plan. However, shares subject to any options surrendered in connection with the stock appreciation right provisions of the Plan shall not be available for reissuance. Should the exercise price of an option under the Plan be paid with shares of Class A Common Stock or should shares of Class A Common Stock otherwise issuable under the Plan be withheld by the Corporation in satisfaction of the withholding taxes incurred in connection with the exercise of an option or the vesting of a stock issuance under the Plan, then the number of shares of Class A Common Stock available for issuance under the Plan shall be reduced by the gross number of shares for which the option is exercised or which vest under the stock issuance, and not by the net number of shares of Class A Common Stock issued to the holder of such option or stock issuance.

D. If any change is made to the Class A Common Stock by reason of any stock split, reverse stock split, stock dividend, distribution, recapitalization, combination or reclassification of shares, exchange of shares or other change affecting the outstanding Class A Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the maximum number and/or class of securities issuable under the Plan, (ii) the number and/or class of securities for which any one person may be granted stock options, separately exercisable stock appreciation rights and direct stock issuances under the Plan per calendar year, (iii) the number and/or class of securities for which grants are subsequently to be made under the Automatic Option Grant Program to new and continuing non-employee Board members, and (iv) the number and/or class of securities and the exercise price per share in effect under each outstanding option under the Plan. Such adjustments to the outstanding options are to be effected in a manner which shall preclude the enlargement or dilution of rights and benefits under such options. The adjustments determined by the Plan Administrator shall be final, binding and conclusive.

E. Should the Corporation effect a divestiture of one or more Subsidiaries through a distribution or spin-off to the Corporation's stockholders of the securities of the Subsidiary held by the Corporation ("Divestiture"), then the Plan Administrator may, in its sole discretion, make appropriate adjustments to the number and/or class of securities subject to each outstanding option and the exercise price

payable per share in order to reflect the effect of the Divestiture on the Corporation's capital structure and the relative Fair Market Values of the Class A Common Stock and the distributed securities of the Subsidiary following the Divestiture. Such adjustment may include the division of the option into two separate options, one for the shares of Class A Common Stock at the time subject to the option and a second option for the securities of the Subsidiary distributable with respect to those shares. The Plan Administrator may also, in its sole discretion, accelerate the vesting and exercisability of the option (or any separated option) with respect to one or more shares of the Class A Common Stock or distributed securities at the time subject to such option (or the separated option), if and to the extent the Optionee is to remain in the Corporation's Service following such Divestiture or is otherwise to provide services to the divested Subsidiary.

ARTICLE TWO

DISCRETIONARY OPTION GRANT PROGRAM

I. OPTION TERMS

Each option shall be evidenced by one or more documents in the form approved by the Plan Administrator; provided, however, that each such document shall comply with the terms specified below. Each document evidencing an Incentive Option shall, in addition, be subject to the provisions of the Plan applicable to such options.

A. *Exercise Price.*

1. The exercise price per share shall be fixed by the Plan Administrator but shall not be less than one hundred percent (100%) of the Fair Market Value per share of Class A Common Stock on the option grant date.
2. The exercise price shall become immediately due upon exercise of the option and shall, subject to the provisions of Section I of Article Five and the documents evidencing the option, be payable in one or more of the forms specified below:
 - (i) cash or check made payable to the Corporation,
 - (ii) shares of Class A Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date, or
 - (iii) to the extent the option is exercised for vested shares, through a special sale and remittance procedure pursuant to which the Optionee shall concurrently provide irrevocable instructions to (a) a Corporation designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (b) the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent such sale and remittance procedure is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

B. *Exercise and Term of Options.* Each option shall be exercisable at such time or times, during such period and for such number of shares as shall be determined by the Plan Administrator and set forth in the documents evidencing the option. However, no option shall have a term in excess of ten (10) years measured from the option grant date.

C. *Effect of Termination of Service.*

1. The following provisions shall govern the exercise of any options held by the Optionee at the time of cessation of Service or death:
 - (i) Any option outstanding at the time of the Optionee's cessation of Service for any reason shall remain exercisable for such period of time thereafter as shall be determined by the Plan Administrator and set forth in the documents evidencing the option, but no such option shall be exercisable after the expiration of the option term.
 - (ii) Any option exercisable in whole or in part by the Optionee at the time of death may be subsequently exercised by the personal representative of the Optionee's estate or by the

person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution.

(iii) During the applicable exercise period following termination of Service, the option may not be exercised in the aggregate for more than the number of vested shares for which the option is exercisable on the date of the Optionee's cessation of Service. Upon the expiration of the applicable exercise period or (if earlier) upon the expiration of the option term, the option

shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Service, terminate and cease to be outstanding to the extent the option is not otherwise at that time exercisable for vested shares.

(iv) Should the Optionee's Service be terminated for Misconduct, then all outstanding options held by the Optionee shall terminate immediately and cease to be outstanding.

2. The Plan Administrator shall have complete discretion, exercisable either at the time an option is granted or at any time while the option remains outstanding, to:

(i) extend the period of time for which the option is to remain exercisable following the Optionee's cessation of Service from the limited exercise period otherwise in effect for that option to such greater period of time as the Plan Administrator shall deem appropriate, but in no event beyond the expiration of the option term, and/or

(ii) permit the option to be exercised, during the applicable Service exercise period following termination of service, not only with respect to the number of vested shares of Class A Common Stock for which such option is exercisable at the time of the Optionee's cessation of Service but also with respect to one or more additional installments in which the Optionee would have vested had the Optionee continued in Service.

D. Stockholder Rights. The holder of an option shall have no stockholder rights with respect to the shares subject to the option until such person shall have exercised the option, paid the exercise price and become a holder of record of the purchased shares.

E. Repurchase Rights. The Plan Administrator shall have the discretion to grant options which are exercisable for unvested shares of Class A Common Stock. Should the Optionee cease Service while holding such unvested shares, the Corporation shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in the document evidencing such repurchase right.

F. Limited Transferability of Options. During the lifetime of the Optionee, Incentive Options shall be exercisable only by the Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following the Optionee's death. However, a Nonstatutory Option may be assigned in whole or in part during the Optionee's lifetime to one or more "family members" (as defined in Rule 701 of the 1933 Act) of the Optionee if such assignment is a gift or pursuant to a domestic relations order. The terms applicable to the assigned portion shall be the same as those in effect for the option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Plan Administrator may deem appropriate.

II. INCENTIVE OPTIONS

The terms specified below shall be applicable to all Incentive Options. Except as modified by the provisions of this Section II, all the provisions of Articles One, Two and Five shall be applicable to

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Incentive Options. Options which are specifically designated as Nonstatutory Options when issued under the Plan shall not be subject to the terms of this Section II.

A. Eligibility. Incentive Options may only be granted to Employees.

B. Dollar Limitation. The aggregate Fair Market Value of the shares of Class A Common Stock (determined as of the respective date or dates of grant) for which one or more options granted to any Employee under the Plan (or any other option plan of the Corporation or any Parent or Subsidiary) may for the first time become exercisable as Incentive Options during any one calendar year shall not exceed the sum of One Hundred Thousand Dollars (\$100,000). To the extent the Employee holds two (2) or more such options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

C. 10% Stockholder. If any Employee to whom an Incentive Option is granted is a 10% Stockholder, then the exercise price per share shall not be less than one hundred ten percent (110%) of the Fair Market Value per share of Class A Common Stock on the option grant date, and the option term shall not exceed five (5) years measured from the option grant date.

III. CORPORATE TRANSACTION/CHANGE IN CONTROL

A. In the event of any Corporate Transaction, each outstanding option shall automatically accelerate so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable with respect to the total number of shares of Class A Common Stock at the time subject to such option and may be exercised for any or all of those shares as fully vested shares of Class A Common Stock. However, an outstanding option shall not become exercisable on such an accelerated basis if and to the extent: (i) such option is, in connection with the Corporate Transaction, to be assumed by the successor corporation (or parent thereof) or (ii) such option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing at the time of the Corporate Transaction on any shares for which the option is not otherwise at that time exercisable and provides for subsequent payout in accordance with the same exercise/vesting schedule applicable to those option shares or (iii) the acceleration of such option is subject to other

limitations imposed by the Plan Administrator at the time of the option grant.

B. All outstanding repurchase rights shall automatically terminate, and the shares of Class A Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent: (i) those repurchase rights are to be assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

C. Immediately following the consummation of the Corporate Transaction, all outstanding options shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments to reflect such Corporate Transaction shall also be made to (i) the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same, (ii) the maximum number and/or class of securities available for issuance over the remaining term of the Plan and (iii) the maximum number and/or class of

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securities for which any one person may be granted stock options, separately exercisable stock appreciation rights and direct stock issuances under the Plan per calendar year.

E. The Plan Administrator shall have the discretionary authority to provide for the automatic acceleration of one or more outstanding options under the Discretionary Option Grant Program upon the occurrence of a Corporate Transaction, whether or not those options are to be assumed in the Corporate Transaction, so that each such option shall, immediately prior to the effect date of such Corporate Transaction, become fully exercisable with respect to the total number of shares of Class A Common Stock at the time subject to that option and may be exercised for any or all of those shares as fully vested shares of Class A Common Stock. In addition, the Plan Administrator shall have the discretionary authority to structure one or more of the Corporation's repurchase rights under the Discretionary Option Grant Program so that those rights shall not be assignable in connection with such Corporate Transaction and shall accordingly terminate upon the consummation of such Corporate Transaction, and the shares subject to those terminated rights shall thereupon vest in full.

F. The Plan Administrator shall have full power and authority, exercisable either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration of one or more outstanding options under the Discretionary Option Grant Program in the event the Optionee's Service is subsequently terminated by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those options are assumed and do not otherwise accelerate. Any options so accelerated shall remain exercisable for fully vested shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (1) year period measured from the effective date of the Involuntary Termination. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights with respect to shares held by the Optionee at the time of such Involuntary Termination shall immediately terminate, and the shares subject to those terminated repurchase rights shall accordingly vest in full.

G. The Plan Administrator shall have the discretionary authority to provide for the automatic acceleration of one or more outstanding options under the Discretionary Option Grant Program upon the occurrence of a Change in Control so that each such option shall, immediately prior to the effect date of such Change in Control, become fully exercisable with respect to the total number of shares of Class A Common Stock at the time subject to that option and may be exercised for any or all of those shares as fully vested shares of Class A Common Stock. Each such accelerated option shall remain exercisable until the expiration or sooner termination of the option term. In addition, the Plan Administrator shall have the discretionary authority to structure one or more of the Corporation's repurchase rights under the Discretionary Option Grant Program so that those rights shall terminate automatically upon the consummation of such Change in Control, and the shares subject to those terminated rights shall thereupon vest in full. Alternatively, the Plan Administrator may condition the automatic acceleration of one or more outstanding options under the Discretionary Option Grant Program and the termination of one or more of the Corporation's outstanding repurchase rights under such program upon the subsequent termination of the Optionee's Service by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of such Change in Control. Each option so accelerated shall remain exercisable for fully vested shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (1) year period measured from the effective date of such Involuntary Termination.

H. The portion of any Incentive Option accelerated in connection with a Corporate Transaction or Change in Control shall remain exercisable as an Incentive Option only to the extent the applicable One Hundred Thousand Dollar (\$100,000) limitation is not exceeded. To the extent such dollar limitation is exceeded, the accelerated portion of such option shall be exercisable as a Nonstatutory Option under the Federal tax laws.

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I. The outstanding options shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

IV. CANCELLATION AND REGRANT OF OPTIONS

The Plan Administrator shall have the authority to effect, at any time and from time to time, with the consent of the affected option holders, the cancellation of any or all outstanding options under the Discretionary Option Grant Program and to grant in substitution new options covering the same or different number of shares of Class A Common Stock but with an exercise price per share equal to the Fair Market Value per share of Class A Common Stock on the new grant date.

V. STOCK APPRECIATION RIGHTS

A. The Plan Administrator shall have the authority to grant to selected Optionees tandem stock appreciation rights and/or limited stock appreciation rights.

B. The following terms shall govern the grant and exercise of tandem stock appreciation rights:

(i) One or more Optionees may be granted the right, exercisable upon such terms as the Plan Administrator may establish, to elect between the exercise of the underlying option for shares Class A Common Stock and the surrender of that option in exchange for a distribution from the Corporation in an amount equal to the excess of (a) the Fair Market Value (on the option surrender date) of the number of shares in which the Optionee is at the time vested under the surrendered option (or surrendered portion) over (b) the aggregate exercise price payable for those shares.

(ii) No such option surrender shall be effective unless it is approved by the Plan Administrator, either at the time of the actual option surrender or at any earlier time. If the surrender is so approved, then the distribution to which the Optionee shall be entitled may be made in shares of Class A Common Stock valued at Fair Market Value on the option surrender date, in cash, or partly in shares and partly in cash, as the Plan Administrator shall in its sole discretion deem appropriate.

(iii) If the surrender of an option is not approved by the Plan Administrator, then the Optionee shall retain whatever rights the Optionee had under the surrendered option (or surrendered portion) on the option surrender date and may exercise such rights at any time prior to the later of (a) five (5) business days after the receipt of the rejection notice or (b) the last day on which the option is otherwise exercisable in accordance with the terms of the documents evidencing such option, but in no event may such rights be exercised more than ten (10) years after the option grant date.

2. The following terms shall govern the grant and exercise of limited stock appreciation rights:

(i) One or more Section 16 Insiders may be granted limited stock appreciation rights with respect to their outstanding options.

(ii) Upon the occurrence of a Hostile Takeover, each individual holding one or more options with such a limited stock appreciation right shall have the unconditional right (exercisable for a thirty (30) day period following such Hostile Takeover) to surrender each such option to the Corporation, to the extent the option is at the time exercisable for vested shares of Class A Common Stock. In return for the surrendered option, the Optionee shall receive a cash distribution from the Corporation in an amount equal to the excess of (A) the Takeover Price of the shares of Class A Common Stock which are at the time vested under each surrendered option

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(or surrendered portion) over (B) the aggregate exercise price payable for those shares. Such cash distribution shall be paid within five (5) days following the option surrender date.

(iii) The Plan Administrator shall pre-approve, at the time the limited right is granted, the subsequent exercise of that right in accordance with the terms of the grant and the provisions of this Section V. No additional approval of the Plan Administrator or the Board shall be required at the time of the actual option surrender and cash distribution.

(iv) The balance of the option (if any) shall remain outstanding and exercisable in accordance with the documents evidencing such option.

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ARTICLE THREE

STOCK ISSUANCE PROGRAM

I. STOCK ISSUANCE TERMS

Shares of Class A Common Stock may be issued under the Stock Issuance Program through direct and immediate issuances without any intervening option grants. Each such stock issuance shall be evidenced by a Stock Issuance Agreement which complies with the terms specified below.

A. *Purchase Price.*

1. The purchase price per share shall be fixed by the Plan Administrator, but shall not be less than one hundred percent (100%)

of the Fair Market Value per share of Class A Common Stock on the issuance date.

2. Subject to the provisions of Section I of Article Five, shares of Class A Common Stock may be issued under the Stock Issuance Program for any combination of the following items of consideration which the Plan Administrator may deem appropriate in each individual instance:

- (i) cash or check made payable to the Corporation, or
- (ii) past services rendered to the Corporation (or any Parent or Subsidiary).

B. Vesting Provisions.

1. Shares of Class A Common Stock issued under the Stock Issuance Program may, in the discretion of the Plan Administrator, be fully and immediately vested upon issuance or may vest in one or more installments over the Participant's period of Service or upon attainment of specified performance objectives. The elements of the vesting schedule applicable to any unvested shares of Class A Common Stock issued under the Stock Issuance Program shall be determined by the Plan Administrator and incorporated into the Stock Issuance Agreement.

2. Any new, substituted or additional securities or other property (including money paid other than as a regular cash dividend) which the Participant may have the right to receive with respect to the Participant's unvested shares of Class A Common Stock by reason of any stock dividend, stock split, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Class A Common Stock as a class without the Corporation's receipt of consideration shall be issued subject to (i) the same vesting requirements applicable to the Participant's unvested shares of Class A Common Stock and (ii) such escrow arrangements as the Plan Administrator shall deem appropriate.

3. The Participant shall have full stockholder rights with respect to any shares of Class A Common Stock issued to the Participant under the Stock Issuance Program, whether or not the Participant's interest in those shares is vested. Accordingly, the Participant shall have the right to vote such shares and to receive any regular cash dividends paid on such shares.

4. Should the Participant cease to remain in Service while holding one or more unvested shares of Class A Common Stock issued under the Stock Issuance Program or should the performance objectives not be attained with respect to one or more such unvested shares of Class A Common Stock, then those shares shall be immediately surrendered to the Corporation for cancellation, and the Participant shall have no further stockholder rights with respect to those shares. To the extent the surrendered shares were previously issued to the Participant for consideration paid in cash or cash equivalent (including the Participant's purchase money indebtedness), the Corporation shall repay to the Participant the cash consideration paid for the surrendered shares and shall cancel the unpaid principal balance of any outstanding purchase money note of the Participant attributable to the surrendered shares.

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5. The Plan Administrator may in its discretion waive the surrender and cancellation of one or more unvested shares of Class A Common Stock which would otherwise occur upon the cessation of the Participant's Service or the non attainment of the performance objectives applicable to those shares. Such waiver shall result in the immediate vesting of the Participant's interest in the shares as to which the waiver applies. Such waiver may be effected at any time, whether before or after the Participant's cessation of Service or the attainment or non-attainment of the applicable performance objectives.

C. Nontransferability of Rights to Purchase. During the lifetime of the Participant, the right to purchase shares of Class A Common Stock pursuant to the Stock Issuance Program shall be exercisable only by the Participant and shall not be assignable or transferable other than by will or by the laws of descent and distribution following the Participant's death.

II. CORPORATE TRANSACTION/CHANGE IN CONTROL

A. All of the Corporation's outstanding repurchase rights under the Stock Issuance Program shall terminate automatically, and all the shares of Class A Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent (i) those repurchase rights are to be assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed in the Stock Issuance Agreement.

B. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued under the Stock Issuance Program or any time while the Corporation's repurchase rights with respect to those shares remain outstanding, to structure one or more of those repurchase rights so that such rights shall not be assignable in connection with a Corporate Transaction and shall accordingly terminate upon the consummation of such Corporate Transaction, and the shares subject to those terminated repurchase rights shall thereupon vest in full.

C. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights remain outstanding under the Stock Issuance Program, to provide that those rights shall automatically terminate in whole or in part, and the shares of Class A Common Stock subject to those terminated rights shall immediately vest, in the event the Participant's Service should subsequently terminate by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those repurchase rights are assigned to the successor corporation (or parent thereof).

D. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights with respect to those shares remain outstanding under the Stock Issuance Program, to structure one or more of those repurchase rights so that such rights shall automatically terminate in whole or in part, and the shares of Class A Common Stock subject to those terminated rights shall immediately vest, upon (i) a Change in Control or (ii) the subsequent termination of the Participant's Service by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of such Change in Control or Involuntary Termination.

III. SHARE ESCROW/LEGENDS

Unvested shares may, in the Plan Administrator's discretion, be held in escrow by the Corporation until the Participant's interest in such shares vests or may be issued directly to the Participant with restrictive legends on the certificates evidencing those unvested shares.

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ARTICLE FOUR

AUTOMATIC OPTION GRANT PROGRAM

I. OPTION TERMS

A. **Grant Dates.** Option grants shall be made on the dates specified below:

1. Each individual serving as a non-employee Board member on the Plan Effective Date shall automatically be granted at that time a Nonstatutory Option to purchase 5,000 shares of Class A Common Stock, provided that individual has not previously been in the employ of the Corporation or any Parent or Subsidiary.

2. Each individual who is first elected or appointed as a non-employee Board member on or after the Plan Effective Date shall automatically be granted, on the date of such initial election or appointment, a Nonstatutory Option to purchase 20,000 shares of Class A Common Stock, provided that individual has not previously been in the employ of the Corporation or any Parent or Subsidiary.

3. In the date of each Annual Stockholders Meeting, beginning with the 1998 Annual Stockholders Meeting, each individual who is to continue to serve as a non-employee Board member, whether or not that individual is standing for reelection to the Board at that particular Annual Meeting, shall automatically be granted a Nonstatutory Option to purchase 5,000 shares of Class A Common Stock, provided such individual has served as a non-employee Board member for at least six (6) months. There shall be no limit on the number of such 5,000 share option grants any one non-employee Board member may receive over his or her period of Board service, and non-employee Board members who have previously been in the employ of the Corporation (or any Parent or Subsidiary) shall be eligible to receive one or more such annual option grants over their period of continued Board service.

B. **Exercise Price.**

1. The exercise price per share shall be equal to one hundred percent (100%) of the Fair Market Value per share of Class A Common Stock on the option grant date.

2. The exercise price shall be payable in one or more of the alternative forms authorized under the Discretionary Option Grant Program. Except to the extent the sale and remittance procedure specified thereunder is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

C. **Option Term.** Each option shall have a term of ten (10) years measured from the option grant date.

D. **Exercise and Vesting of Options.** Each initial 20,000 share option grant shall be immediately exercisable for any or all of the option shares as fully vested shares of Class A Common Stock and shall remain so exercisable until the expiration or sooner termination of the option term. Each annual 5,000 share grant shall also be immediately exercisable for any or all of the option shares. However, the shares of Class A Common Stock purchased under each annual 5,000 share grant shall be subject to repurchase by the Corporation, at the exercise price paid per share, upon the Optionee's cessation of Board service prior to vesting in those shares. Each annual 5,000 share grant shall vest, and the Corporation's repurchase right shall lapse, in a series of four (4) successive equal annual installments upon the Optionee's completion of each year of Board service over the four (4) year period measured from the automatic grant date.

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E. **Termination of Board Service.** The following provisions shall govern the exercise of any options held by the Optionee at the time the Optionee ceases to serve as a Board member:

(i) The Optionee (or, in the event of Optionee's death, the personal representative of the Optionee's estate or the person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution) shall have a twelve (12) month period following the date of such cessation of Board service in which to exercise each such option.

(ii) During the twelve (12) month exercise period, the option may not be exercised in the aggregate for more than the number of vested shares of Class A Common Stock for which the option is exercisable at the time of the Optionee's cessation of Board service.

(iii) Should the Optionee cease to serve as a Board member by reason of death or Permanent Disability, then all shares at the time subject to the option shall immediately vest so that such option may, during the twelve (12) month exercise period following such cessation of Board service, be exercised for all or any portion of those shares as fully vested shares of Class A Common Stock.

(iv) In no event shall the option remain exercisable after the expiration of the option term. Upon the expiration of the twelve (12) month exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Board service for any reason other than death or Permanent Disability, terminate and cease to be outstanding to the extent the option is not otherwise at that time exercisable for vested shares.

II. CORPORATE TRANSACTION/CHANGE IN CONTROL/HOSTILE TAKEOVER

A. The shares of Class A Common Stock subject to each option outstanding under this Article Four at the time of a Corporate Transaction but not otherwise vested shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of the shares of Class A Common Stock at the time subject to such option and may be exercised for all or any portion of those shares as fully vested shares of Class A Common Stock. Immediately following the consummation of the Corporate Transaction, each automatic option grant shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

B. The shares of Class A Common Stock subject to each option outstanding under this Article Four at the time of a Change in Control but not otherwise vested shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Change in Control, become fully exercisable for all of the shares of Class A Common Stock at the time subject to such option and may be exercised for all or any portion of those shares as fully vested shares of Class A Common Stock. Each such option shall remain exercisable for such fully vested option shares until the expiration or sooner termination of the option term or the surrender of the option in connection with a Hostile Takeover.

C. All outstanding repurchase rights under the Automatic Option Grant Program shall automatically terminate, and the unvested shares of Class A Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction or Change in Control.

D. Upon the occurrence of a Hostile Takeover, the Optionee shall have a thirty (30) day period in which to surrender to the Corporation each of his or her outstanding automatic option grants. The Optionee shall in return be entitled to a cash distribution from the Corporation in an amount equal to the excess of (i) the Takeover Price of the shares of Class A Common Stock at the time subject to each

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surrendered option (whether or not the Optionee is otherwise at the time vested in those shares) over (ii) the aggregate exercise price payable for such shares. Such cash distribution shall be paid within five (5) days following the surrender of the option to the Corporation. Stockholder approval of the Plan on the Plan Effective Date shall constitute pre-approval of the grant of each such option surrender right under this Automatic Option Grant Program and the subsequent exercise of that right in accordance with the terms and provisions of this Section II.

E. No additional approval or consent of the Plan Administrator or the Board shall be required at the time of the actual option surrender and cash distribution.

F. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same.

G. The grant of options under the Automatic Option Grant Program shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

III. REMAINING TERMS

The remaining terms of each option granted under the Automatic Option Grant Program shall be the same as the terms in effect for option grants made under the Discretionary Option Grant Program.

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ARTICLE FIVE
MISCELLANEOUS

I. FINANCING

The Plan Administrator may permit any Optionee or Participant to pay the option exercise price under the Discretionary Option Grant Program or the purchase price of shares issued under the Stock Issuance Program by delivering a full recourse, interest bearing promissory note payable in one or more installments. The terms of any such promissory note (including the interest rate and the terms of repayment) shall be established by the Plan Administrator in its sole discretion. In no event may the maximum credit available to the Optionee or Participant exceed the sum of (i) the aggregate option exercise price or purchase price payable for the purchased shares (less the par value of those shares) plus (ii) any Federal, state and local income and employment tax liability incurred by the Optionee or the Participant in connection with the option exercise or share purchase.

II. TAX WITHHOLDING

A. The Corporation's obligation to deliver shares of Class A Common Stock upon the exercise of options or the issuance or vesting of such shares under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

B. The Plan Administrator may, in its discretion, provide any or all holders of Nonstatutory Options or unvested shares of Class A Common Stock under the Plan (other than the options granted or the shares issued under the Automatic Option Grant Program) with the right to use shares of Class A Common Stock in satisfaction of all or part of the Taxes incurred by such holders in connection with the exercise of their options or the vesting of their shares. Such right may be provided to any such holder in either or both of the following formats:

1. **Stock Withholding:** The election to have the Corporation withhold, from the shares of Class A Common Stock otherwise issuable upon the exercise of such Nonstatutory Option or the vesting of such shares, a portion of those shares with an aggregate Fair Market Value equal to the percentage of the Taxes (not to exceed one hundred percent (100%)) designated by the holder.

2. **Stock Delivery:** The election to deliver to the Corporation, at the time the Nonstatutory Option is exercised or the shares vest, one or more shares of Class A Common Stock previously acquired by such holder (other than in connection with the option exercise or share vesting triggering the Taxes) with an aggregate Fair Market Value equal to the percentage of the Taxes (not to exceed one hundred percent (100%)) designated by the holder.

III. EFFECTIVE DATE AND TERM OF THE PLAN

A. The Plan was adopted by the Board on July 25, 1997 and shall become effective upon approval by the Corporation's stockholders at the 1997 Annual Meeting held on the Plan Effective Date.

B. The Plan shall terminate upon the earliest to occur of (i) July 25, 2007, (ii) the date on which all shares available for issuance under the Plan shall have been issued as fully vested shares or (iii) the termination of all outstanding options in connection with a Corporate Transaction. Upon such plan termination, all outstanding option grants and unvested stock issuances shall thereafter continue to have force and effect in accordance with the provisions of the documents evidencing those grants or issuances.

IV. AMENDMENT OF THE PLAN

A. The Board shall have complete and exclusive power and authority to amend or modify the Plan in any or all respects. However, no such amendment or modification shall adversely affect the rights and obligations with respect to stock options or unvested stock issuances at the time outstanding under the Plan unless the Optionee or the Participant consents to such amendment or modification. In addition, certain amendments may require stockholder approval pursuant to applicable laws or regulations.

B. The Board amended the Plan in 1999 to increase the number of shares of Class A Common Stock reserved for issuance under the Plan from 530,000 to 930,000. The Plan was amended in 2000 to (1) increase the number of shares of Class A Common Stock reserved for issuance under the Plan by an additional 400,000 shares, (2) increase the number of shares of Class A Common Stock subject to the initial automatic option grant pursuant to the Automatic Option Grant Program from 5,000 shares to 20,000 shares and (3) increase the number of shares of Class A Common Stock subject to the annual automatic option grant pursuant to the Automatic Option Grant Program from 4,000 shares to 5,000 shares. In 2001, the Plan was amended to increase the number of shares of Class A Common Stock reserved for issuance under the Plan by 475,000 shares. In 2002, the Plan was amended to comply with the requirements of the California Department of Corporations.

C. Options to purchase shares of Class A Common Stock may be granted under the Discretionary Option Grant Program and shares of Class A Common Stock may be issued under the Stock Issuance Program that are in each instance in excess of the number of shares then available for issuance under the Plan, provided any excess shares actually issued under those programs shall be held in escrow until there is obtained stockholder approval of an amendment sufficiently increasing the number of shares of Class A Common Stock available for

issuance under the Plan. If such stockholder approval is not obtained within twelve (12) months after the date the first such excess issuances are made, then (i) any unexercised options granted on the basis of such excess shares shall terminate and cease to be outstanding and (ii) the Corporation shall promptly refund to the Optionees and the Participants the exercise or purchase price paid for any excess shares issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) for the period the shares were held in escrow, and such shares shall thereupon be automatically cancelled and cease to be outstanding.

V. USE OF PROCEEDS

Any cash proceeds received by the Corporation from the sale of shares of Class A Common Stock under the Plan shall be used for general corporate purposes.

VI. REGULATORY APPROVALS

A. The implementation of the Plan, the granting of any stock option under the Plan and the issuance of any shares of Class A Common Stock (i) upon the exercise of any granted option or (ii) under the Stock Issuance Program shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the stock options granted under it and the shares of Class A Common Stock issued pursuant to it.

B. No shares of Class A Common Stock or other assets shall be issued or delivered under the Plan unless and until there shall have been compliance with all applicable requirements of Federal and state securities laws, including the filing and effectiveness of the Form S-8 registration statement for the shares of Class A Common Stock issuable under the Plan, and all applicable listing requirements of any stock exchange (or the Nasdaq National Market, if applicable) on which Class A Common Stock is then listed for trading.

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VII. NO EMPLOYMENT/SERVICE RIGHTS

Nothing in the Plan shall confer upon the Optionee or the Participant any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining such person) or of the Optionee or the Participant, which rights are hereby expressly reserved by each, to terminate such person's Service at any time for any reason, with or without cause.

VIII. CALIFORNIA BLUE SKY PROVISIONS

If the Class A Common Stock is not exempt from California securities laws, the following provisions shall apply to any sale of Class A Common Stock or any option grant to an individual who is eligible to receive such grants pursuant to the Plan who resides in the State of California.

A. *Option Grant Program.*

1. If the person to whom the option is granted is a 10% Stockholder, then the exercise price per share shall not be less than 110% of the Fair Market Value per share of Class A Common Stock on the date the option is granted.
2. The Plan Administrator may not impose a vesting schedule upon any option grant or the shares of Class A Common Stock subject to that option which is more restrictive than 20% per year vesting, with the initial vesting to occur not later than one year after the option grant date. However, such limitation shall not be applicable to any option grants made to individuals who are officers of the Corporation, non-employee Board members or consultants.
3. Unless the Optionee's Service is terminated for Misconduct (in which case the option shall terminate immediately), the option (to the extent it was vested and exercisable at that the time Optionee's Service ceased) must remain exercisable, following Optionee's termination of Service, for at least (a) six months if Optionee's Service terminates due to death or Permanent Disability or (b) thirty days in all other cases.

B. ***Stock Issuance Program.*** The Plan Administrator may not impose a vesting schedule upon any stock issuance effected under the Stock Issuance Program which is more restrictive than 20% per year vesting, with initial vesting to occur not later than one year after the issuance date. Such limitation shall not apply to any Class A Common Stock issuances made to the officers of the Corporation, non-employee Board members or consultants.

C. ***Repurchase Rights.*** To the extent specified in a stock purchase agreement or stock issuance agreement, the Corporation and/or its stockholders shall have the right to repurchase any or all of the unvested shares of Class A Common Stock held by an Optionee or Participant when such person's Service ceases. However, except with respect to grants to officers, non-employee Board members, and consultants of the Corporation, the repurchase right must satisfy the following conditions:

1. The Corporation's right to repurchase the unvested shares of Class A Common Stock must lapse at the rate of at least 20% per year over five years from the date the option was granted or the shares were issued under the Plan.
2. The Corporation's repurchase right must be exercised within ninety days of the date that Service ceased (or the date the shares were purchased, if later).

3. The purchase price must be paid in the form of cash or cancellation of the purchase money indebtedness for the shares of Class A Common Stock.

D. **Information Requirements.** Annually, the Corporation shall deliver or cause to be delivered to each Optionee or Participant, no later than such information is delivered to the Corporation's security holders, one of the following:

1. The Corporation's annual report to security holders containing the information required by Rule 14a-3(b) under the 1934 Act for its latest fiscal year;
2. The Corporation's annual report on Form 10-K for its latest fiscal year;
3. The Corporation's latest prospectus filed pursuant to 424(b) under the 1933 Act that contains audited financial statements for the latest fiscal year, provided that the financial statements are not incorporated by reference from another filing, and provided further that such prospectus contains substantially the information required by Rule 14a-3(b); or
4. The Corporations' effective 1934 Act registration statement containing audited financial statements for the latest fiscal year.

APPENDIX

The following definitions shall be in effect under the Plan:

- A. **Automatic Option Grant Program** shall mean the automatic option grant program in effect under the Plan.
- B. **Board** shall mean the Corporation's Board of Directors.
- C. **Change in Control** shall mean a change in ownership or control of the Corporation effected through either of the following transactions:
 - (i) the acquisition, directly or indirectly by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders, or
 - (ii) a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board members ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time the Board approved such election or nomination.
- D. **Class A Common Stock** shall mean the Corporation's Class A Common Stock, which shall be registered under Section 12(g) of the 1934 Act and shall be entitled to one-tenth of one vote per share on all matters subject to stockholder approval.
- E. **Code** shall mean the Internal Revenue Code of 1986, as amended.
- F. **Corporate Transaction** shall mean either of the following stockholder approved transactions to which the Corporation is a party:
 - (i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or
 - (ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.
- G. **Corporation** shall mean Odetics, Inc., a Delaware corporation, and its successors.
- H. **Discretionary Option Grant Program** shall mean the discretionary option grant program in effect under the Plan.
- I. **Eligible Director** shall mean a non-employee Board member eligible to participate in the Automatic Option Grant Program in accordance with the eligibility provisions of Article One.
- J. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the

control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

K. **Exercise Date** shall mean the date on which the Corporation shall have received written notice of the option exercise.

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L. **Fair Market Value** per share of Class A Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Class A Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be deemed equal to the closing selling price per share of Class A Common Stock on the date in question, as such price is reported on the Nasdaq National Market or any successor system. If there is no closing selling price for the Class A Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Class A Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be deemed equal to the closing selling price per share of Class A Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Class A Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Class A Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

M. **Hostile Takeover** shall mean the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders which the Board does not recommend such stockholders to accept.

N. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

O. **Involuntary Termination** shall mean the termination of the Service of any individual which occurs by reason of:

(i) such individual's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) such individual's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her duties and responsibilities or the level of management to which he or she reports, (B) a reduction in his or her level of compensation (including base salary, fringe benefits and target bonus under any corporate performance based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of such individual's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without the individual's consent.

P. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by the Optionee or Participant, any unauthorized use or disclosure by such person of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by such person adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of any Optionee, Participant or other person in the Service of the Corporation (or any Parent or Subsidiary).

Q. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

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R. **1933 Act** shall mean the Securities Act of 1933, as amended.

S. **Nonstatutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

T. **Optionee** shall mean any person to whom an option is granted under the Discretionary Option Grant or Automatic Option Grant Program.

U. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

V. **Participant** shall mean any person who is issued shares of Class A Common Stock under the Stock Issuance Program.

W. **Permanent Disability** or **Permanently Disabled** shall mean the inability of the Optionee or the Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) months or more. However, solely for purposes of the Automatic Option Grant Program, Permanent Disability or Permanently Disabled shall mean the inability of the non-employee Board member to perform his or her usual duties as a Board member by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) months or more.

X. **Plan** shall mean the Corporation's 1997 Stock Incentive Plan, as set forth in this document.

Y. **Plan Administrator** shall mean the particular entity, whether the Primary Committee, the Board or the Secondary Committee, which is authorized to administer the Discretionary Option Grant and Stock Issuance Programs with respect to one or more classes of eligible persons, to the extent such entity is carrying out its administrative functions under those programs with respect to the persons under its jurisdiction.

Z. **Plan Effective Date** shall mean September 5, 1997, the date of the 1997 Annual Stockholders Meeting at which the Plan is approved by the Corporation's stockholders.

AA. **Primary Committee** shall mean the committee of two (2) or more non-employee Board members appointed by the Board to administer the Discretionary Option Grant and Stock Issuance Programs with respect to Section 16 Insiders.

BB. **Secondary Committee** shall mean a committee of one (1) or more Board members appointed by the Board to administer the Discretionary Option Grant and Stock Issuance Programs with respect to eligible persons other than Section 16 Insiders.

CC. **Section 16 Insider** shall mean an officer or director of the Corporation subject to the short swing profit liabilities of Section 16 of the 1934 Act.

DD. **Service** shall mean the performance of services for the Corporation (or any Parent or Subsidiary) by a person in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor, except to the extent otherwise specifically provided in the documents evidencing the option grant or stock issuance.

EE. **Stock Exchange** shall mean either the American Stock Exchange or the New York Stock Exchange.

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FF. **Stock Issuance Agreement** shall mean the agreement entered into by the Corporation and the Participant at the time of issuance of shares of Class A Common Stock under the Stock Issuance Program.

GG. **Stock Issuance Program** shall mean the stock issuance program in effect under the Plan.

HH. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

II. **Takeover Price** shall mean the greater of (i) the Fair Market Value per share of Class A Common Stock on the date the option is surrendered to the Corporation in connection with a Hostile Takeover or (ii) the highest reported price per share of Class A Common Stock paid by the tender offeror in effecting such Hostile Takeover. However, if the surrendered option is an Incentive Option, the Takeover Price shall not exceed the clause (i) price per share.

JJ. **Taxes** shall mean the Federal, state and local income and employment tax liabilities incurred by the holder of Nonstatutory Options or unvested shares of Class A Common Stock in connection with the exercise of those options or the vesting of those shares.

KK. **10% Stockholder** shall mean the owner of stock (as determined under Code Section 424(d)) possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Corporation (or any Parent or Subsidiary).

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[LOGO] AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION

STANDARD SUBLEASE
MULTI-TENANT

1. Basic Provisions ("Basic Provisions").

1.1 Parties: This Sublease ("Sublease"), dated for reference purposes only May 7, 2003, is made by and between Odetics, Inc, a Delaware corporation (" Sublessor") and FEI-Zyfer, Inc., a Delaware corporation ("Sublessee"), (collectively the "Parties", or individually a "Party").

1.2(a) Premises: That certain portion of the Project (as defined below), known as 1515-1585 S. Manchester Ave., Anaheim, consisting of approximately 20,000 square feet, currently occupied by Zyfer, Inc. ("Premises"). The Premises are located at: 1585 S. Manchester Ave., in the City of Anaheim, County of Orange, State of California, with zip code 92802. In addition to Lessee's rights to use and occupy the Premises as hereinafter specified, Lessee shall have nonexclusive rights to the Common Areas (as defined below) as hereinafter specified, but shall not have any rights to the roof, the exterior walls, or the utility raceways of the building containing the Premises ("Building") or to any other buildings in the Project. The Premises, the Building, the Common Areas, the land upon which they are located, along with all other buildings and improvements thereon, are herein collectively referred to as the " Project."

1.2(b) Parking: 50 unreserved and 0 reserved vehicle parking spaces.

1.3 Term: two years and zero months commencing see Addendum 22 ("Commencement Date") and ending see Addendum 23 ("Expiration Date").

1.4 Early Possession: n/a ("Early Possession Date").

1.5 Base Rent: \$20,400.00 per month ("Base Rent"), payable on the _____ day of each month commencing _____.

☐ If this box is checked, there are provisions in this Lease for the Base Rent to be adjusted.

1.6 Lessee's Share of Operating Expenses: 0 percent (0%) ("Lessee's Share").

1.7 Base Rent and Other Monies Paid Upon Execution :

- (a) Base Rent: \$20,400.00 for the period _____
(b) Security Deposit: \$20,400.00 ("Security Deposit").
(c) Other: \$0.00 for n/a
(d) Total Due Upon Execution of this Lease: \$40,800.00.

1.8 Agreed Use: The design, manufacture, testing and assembly of electrical components and related legal uses.

1.9 Real Estate Brokers:

1.10 Guarantor. The obligations of the Sublessee under this Sublease shall be guaranteed by Frequency Electronics, Inc. ("Guarantor").

1.11 Attachments. Attached hereto are the following, all of which constitute a part of this Sublease:

☒ an Addendum consisting of Paragraphs 14 through 23;

☐ a plot plan depicting the Premises and/or Project;

☐ a current set of the Rules and Regulations;

☐ a Work Letter;

☒ a copy of the Master Lease;

☐ other (specify):

2. Premises.

2.1 Letting. Sublessor hereby subleases to Sublessee, and Sublessee hereby subleases from Sublessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Sublease. Unless otherwise provided herein, any statement of size set forth in this Sublease, or that may have been used in calculating Rent, is an approximation which the Parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less. Note: Sublessee is advised to verify the actual size prior to executing this Sublease.

2.2 Condition. Sublessor shall deliver the Premises to Sublessee broom clean and free of debris on the Commencement Date or the Early Possession Date, whichever first occurs ("Start Date"), and warrants that the existing electrical, plumbing, fire sprinkler, lighting, heating, ventilating and air conditioning systems ("HVAC"), and any items which the Lessor is obligated to construct pursuant to the Work Letter attached hereto, if any, other than those constructed by Lessee, shall be in good operating condition on said date. If a noncompliance with such warranty exists as of the Start Date, or if one of such systems or elements should malfunction or fail within the appropriate warranty period, Sublessor shall, as Sublessor's sole obligation with respect to such matter, except as otherwise provided in this Sublease, promptly after receipt of written notice from Sublessee setting forth with specificity the nature and extent of such noncompliance, malfunction or failure, rectify same at Sublessor's expense. The warranty periods shall be as follows: Cotermminus with the term of this Sublease.

2.3 Compliance. Sublessor warrants that any improvements, alterations or utility installations made or installed by or on behalf of Sublessor to or on the Premises comply with all applicable covenants or restrictions of record and applicable building codes, regulations and ordinances ("Applicable Requirements") in effect on the date that they were made or installed. Sublessor makes no warranty as to the use to which Sublessee will put the Premises or to modifications which may be required by the Americans with Disabilities Act or any similar laws as a result of Sublessee's use. If the Premises do not comply with said warranty, Sublessor shall, except as otherwise provided, promptly after receipt of written notice from Sublessee setting forth with specificity the nature and extent of such noncompliance, rectify the same.

2.4 Acknowledgements. Sublessee acknowledges that: (a) it has been advised by Sublessor and/or Brokers to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical, HVAC and fire sprinkler systems, security, environmental aspects, and compliance with Applicable Requirements and the Americans with Disabilities Act), and their suitability for Sublessee's intended use, (b) Except as specified herein, Sublessee has made such investigation as it deems necessary with reference to such matters and assumes all responsibility therefor as the same relate to its occupancy of the Premises, and (c) neither Sublessor, Sublessor's agents, nor Brokers have made any oral or written representations or warranties with respect to said matters other than as set forth in this Sublease. In addition, Sublessor acknowledges that: (i) Brokers have made no representations, promises or warranties concerning Sublessee's ability to honor the Sublease or suitability to occupy the Premises, and (ii) it is Sublessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

2.5 Americans with Disabilities Act. In the event that as a result of Sublessee's use, or intended use, of the Premises the Americans with Disabilities Act or any similar law requires modifications or the construction or installation of improvements in or to the Premises, Building, Project and/or Common Areas, the Parties agree that such modifications, construction or improvements shall be made at:

Sublessor's expense Sublessee's expense.

2.6 Vehicle Parking. Sublessee shall be entitled to use the number of Unreserved Parking Spaces and Reserved Parking Spaces specified in Paragraph 1.2(b) on those portions of the Common Areas designated from time to time for parking. Sublessee shall not use more parking spaces than said number. Said parking spaces shall be used for parking by vehicles no larger than fullsize passenger automobiles or pickup trucks, herein called "**Permitted Size Vehicles.**" Sublessor may regulate the loading and unloading of vehicles by adopting Rules and Regulations as provided in Paragraph 2.9. No vehicles other than Permitted Size Vehicles may be parked in the Common Area without the prior written permission of Sublessor.

(a) Sublessee shall not permit or allow any vehicles that belong to or are controlled by Sublessee or Sublessee's employees, suppliers, shippers, customers, contractors or invitees to be loaded, unloaded, or parked in areas other than those designated by Sublessor for such activities.

(b) Sublessee shall not service or store any vehicles in the Common Areas.

(c) If Sublessee permits or allows any of the prohibited activities described in this Paragraph 2.6, then Sublessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove or tow away the vehicle involved and charge the cost to Sublessee, which cost shall be immediately payable upon demand by Sublessor.

2.7 Common Areas—Definition. The term "**Common Areas**" is defined as all areas and facilities outside the Premises and within the exterior boundary line of the Project and interior utility raceways and installations within the Premises that are provided and designated by the Sublessor from time to time for the general nonexclusive use of Sublessor, Sublessee and other tenants of the Project and their respective employees, suppliers, shippers, customers, contractors and invitees, including parking areas, loading and unloading areas, trash areas, roadways, walkways, driveways and landscaped areas.

2.8 Common Areas—Sublessee's Rights. Sublessor grants to Sublessee, for the benefit of Sublessee and its employees, suppliers, shippers, contractors, customers and invitees, during the term of this Sublease, the nonexclusive right to use, in common with others entitled to such use, the Common Areas as they exist from time to time, subject to any rights, powers, and privileges reserved by Sublessor under the terms hereof or under the terms of any rules and regulations or restrictions governing the use of the Project. Under no circumstances shall the right herein granted to use the Common Areas be deemed to include the right to store any property, temporarily or permanently, in the Common Areas. Any such storage shall be permitted only by the prior written consent of Sublessor or Sublessor's designated agent, which consent may be revoked at any time. In the event that any unauthorized storage shall occur then Sublessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove the property and charge the cost to Sublessee, which cost shall be immediately payable upon demand by Sublessor.

2.9 Common Areas—Rules and Regulations. Sublessor or such other person(s) as Sublessor may appoint shall have the exclusive control and management of the Common Areas and shall have the right, from time to time, to establish, modify, amend and enforce reasonable and non-discriminatory rules and regulations ("**Rules and Regulations**") for the management, safety, care, and cleanliness of the grounds, the parking and unloading of vehicles and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Project and their invitees. Sublessee agrees to abide by and conform to all such Rules and Regulations, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Sublessor shall not be responsible to Sublessee for the noncompliance with said Rules and Regulations by other tenants of the Project.

2.10 Common Areas—Changes. Sublessor shall have the right, in Sublessor's sole discretion, from time to time:

(a) To make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of driveways, entrances, parking spaces, parking areas, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways and utility raceways which does not impair in any material manner Sublessee's prior use;

(b) To close temporarily any of the Common Areas for maintenance purposes so long as reasonable access to the Premises remains available;

(c) To add additional buildings and improvements to the Common Areas;

(d) To use the Common Areas while engaged in making additional improvements, repairs or alterations to the Project, or any portion thereof; and

(e) To do and perform such other acts and make such other changes in, to or with respect to the Common Areas and Project as Sublessor may, in the exercise of sound business judgment, deem to be appropriate.

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3. Possession.

3.1 Early Possession. If Sublessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay Base Rent shall be abated for the period of such early possession. All other terms of this Sublease (including but not limited to the obligations to pay Sublessee's Share of Common Area Operating Expenses, Real Property Taxes and insurance premiums and to maintain the Premises) shall, however, be in effect during such period. Any such early possession shall not affect the Expiration Date.

3.2 Delay in Commencement. Sublessor shall deliver possession of the Premises by the Commencement Date.

3.4 Sublessee Compliance. Sublessor shall not be required to tender possession of the Premises to Sublessee until Sublessee complies with its obligation to provide evidence of insurance. Pending delivery of such evidence, Sublessee shall be required to perform all of its obligations under this Sublease from and after the Start Date, including the payment of Rent, notwithstanding Sublessor's election to withhold possession pending receipt of such evidence of insurance. Further, if Sublessee is required to perform any other conditions prior to or concurrent with the Start Date, the Start Date shall occur but Sublessor may elect to withhold possession until such conditions are satisfied.

4. Rent and Other Charges.

4.1 Rent Defined. All monetary obligations of Sublessee to Sublessor under the terms of this Sublease (except for the Security Deposit) are deemed to be rent ("**Rent**"). Rent shall be payable in lawful money of the United States to Sublessor at the address stated herein or to such other persons or at such other places as Sublessor

may designate in writing.

4.3 **Utilities.** Sublessor Sublessee shall pay for all water, gas, heat, light, power, telephone, trash disposal and other utilities and services excluding janitorial services supplied to the Premises, together with any taxes thereon.

5. **Security Deposit.** The rights and obligations of Sublessor and Sublessee as to said Security Deposit shall be as set forth in Paragraph 5 of the Master Lease (as modified by Paragraph 7.3 of this Sublease). As if that language had not been stricken, as modified by Addendum 17.

6. **Agreed Use.** The Premises shall be used and occupied only for the design, manufacture, testing and assembly of electrical components and related legal uses and for no other purpose.

7. **Master Lease.** See Addendum 18.

7.1 Sublessor is the lessee of the Premises by virtue of a lease, hereinafter the "**Master Lease**", wherein 1515 S. Manchester, LLC is the lessor, hereinafter the "**Master Lessor**".

7.2 This Sublease is and shall be at all times subject and subordinate to the Master Lease.

7.3 The terms, conditions and respective obligations of Sublessor and Sublessee to each other under this Sublease shall be the terms and conditions of the Master Lease except for those provisions of the Master Lease which are directly contradicted by this Sublease in which event the terms of this Sublease document shall control over the Master Lease. Therefore, for the purposes of this Sublease, wherever in the Master Lease the word "Lessor" is used it shall be deemed to mean the Sublessor herein and wherever in the Master Lease the word "Lessee" is used it shall be deemed to mean the Sublessee herein.

7.4 During the term of this Sublease and for all periods subsequent for obligations which have arisen prior to the termination of this Sublease, Sublessee does hereby expressly assume and agree to perform and comply with, for the benefit of Sublessor and Master Lessor, each and every obligation of Sublessor under the Master Lease, with respect to the Premises hereunder only, except for the following paragraphs which are excluded therefrom: 1.2, 1.3, 1.5, 1.6, 3.1, 4.3, 6.2(e), 6.2(f), 7.1(b), 7.2, 7.4(b), the parenthetical clause in 7.4 (c), 8.1, 8.2, 8.3, 10, 11, 13.1(c)(ii), 20, 22, 25, 30, 42, 51, 52(C), 52(E), 52(F) 52(G).

7.5 The obligations that Sublessee has assumed under paragraph 7.4 hereof are hereinafter referred to as the "**Sublessee's Assumed Obligations**". The obligations that sublessee has not assumed under paragraph 7.4 hereof are hereinafter referred to as the "**Sublessor's Remaining Obligations**".

7.6 Sublessee shall hold Sublessor free and harmless from all liability, judgments, costs, damages, claims or demands, including reasonable attorneys fees, arising out of Sublessee's failure to comply with or perform Sublessee's Assumed Obligations.

7.7 Sublessor agrees to maintain the Master Lease during the entire term of this Sublease, subject, however, to any earlier termination of the Master Lease without the fault of the Sublessor, and to comply with or perform Sublessor's Remaining Obligations and to hold Sublessee free and harmless from all liability, judgments, costs, damages, claims or demands arising out of Sublessor's failure to comply with or perform Sublessor's Remaining Obligations.

7.8 Sublessor represents to Sublessee that the Master Lease is in full force and effect and that no default exists on the part of any Party to the Master Lease.

8. **Assignment of Sublease and Default.**

8.1 Sublessor hereby assigns and transfers to Master Lessor the Sublessor's interest in this Sublease, subject however to the provisions of Paragraph 8.2 hereof.

8.2 Master Lessor, by executing this document, agrees that until a Default (as defined in the Master Lease) shall occur under the Master Lease, that Sublessor may receive, collect and enjoy the Rent accruing under this Sublease. However, if a Default (as defined in the Master Lease) shall occur in the Master Lease then Master Lessor may, at its option, receive and collect, directly from Sublessee, all Rent owing and to be owed under this Sublease. Master Lessor shall not, by reason of this assignment of the Sublease nor by reason of the collection of the Rent from the Sublessee, be deemed liable to Sublessee for any failure of the Sublessor to perform and comply with Sublessor's Remaining Obligations.

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8.3 Sublessor hereby irrevocably authorizes and directs Sublessee upon receipt of any written notice from the Master Lessor stating that a Default exists under the Master Lease, to pay to Master Lessor the Rent due and to become due under the Sublease. Sublessor agrees that Sublessee shall have the right to rely upon any such statement and request from Master Lessor, and that Sublessee shall pay such Rent to Master Lessor without any obligation or right to inquire as to whether such Default exists and notwithstanding any notice from or claim from Sublessor to the contrary and Sublessor shall have no right or claim against Sublessee for any such Rent so paid by Sublessee.

8.4 No changes or modifications shall be made to this Sublease without the consent of Master Lessor.

9. **Consent of Master Lessor.**

9.1 In the event that the Master Lease requires that Sublessor obtain the consent of Master Lessor to any subletting by Sublessor then, this Sublease shall not be effective unless, within 10 days of the date hereof, Master Lessor signs this Sublease thereby giving its consent to this Subletting.

9.2 In the event that the obligations of the Sublessor under the Master Lease have been guaranteed by third parties then neither this Sublease, nor the Master Lessor's consent, shall be effective unless, within 10 days of the date hereof, said guarantors sign this Sublease thereby giving their consent to this Sublease.

9.3 In the event that Master Lessor does give such consent then:

(a) Such consent shall not release Sublessor of its obligations or alter the primary liability of Sublessor to pay the Rent and perform and comply with all of the obligations of Sublessor to be performed under the Master Lease.

(b) The acceptance of Rent by Master Lessor from Sublessee or any one else liable under the Master Lease shall not be deemed a waiver by Master Lessor of any provisions of the Master Lease.

(c) The consent to this Sublease shall not constitute a consent to any subsequent subletting or assignment.

(d) In the event of any Default of Sublessor under the Master Lease, Master Lessor may proceed directly against Sublessor, any guarantors or any one else liable under the Master Lease or this Sublease without first exhausting Master Lessor's remedies against any other person or entity liable thereon to Master Lessor.

(e) Master Lessor may consent to subsequent sublettings and assignments of the Master Lease or this Sublease or any amendments or modifications thereto without notifying Sublessor or any one else liable under the Master Lease and without obtaining their consent and such action shall not relieve such persons from liability.

(f) In the event of a Default (as defined in the Master Lease) under the Master Lease, then Master Lessor may exercise any or all of its rights and remedies

under the Master Lease without regard to the existence of this Sublease or, at its option and without being obligated to do so, may require Sublessee to attorn to Master Lessor on the terms and conditions of this Sublease in which event Master Lessor shall undertake the obligations of Sublessor under this Sublease from the time of the exercise of said option to termination of this Sublease but Master Lessor shall not be liable for any prepaid Rent nor any Security Deposit paid by Sublessee, nor shall Master Lessor be liable for any other Defaults of the Sublessor under the Sublease. See Addendum 19.

9.4 The signatures of the Master Lessor and any Guarantors of Sublessor at the end of this document shall constitute their consent to the terms of this Sublease.

9.5 Master Lessor acknowledges that, to the best of Master Lessor's knowledge, no Default presently exists under the Master Lease of obligations to be performed by Sublessor and that the Master Lease is in full force and effect.

9.6 Such consent, and this Sublease, shall not be construed to modify, waive or affect any of the terms or provisions of the Master Lease, regardless of any inconsistency between this Sublease and the Master Lease. Without limiting the foregoing, this Sublease and Master Lessor's consent to it do not create any obligations of Master Lessor to Sublessee or any rights of Sublessee enforceable against Master Lessor.

11. Representations and Indemnities of Broker Relationships. The Parties each represent and warrant to the other that it has had no dealings with any person, firm, broker or finder (other than the Brokers, if any) in connection with this Sublease, and that no one other than said named Brokers is entitled to any commission or finder's fee in connection herewith. Sublessee and Sublessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses, attorneys' fees reasonably incurred with respect thereto.

12. Attorney's fees. If any Party or Broker brings an action or proceeding involving the Premises whether founded in tort, contract or equity, or to declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, "**Prevailing Party**" shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. In addition, Sublessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach (\$200 is a reasonable minimum per occurrence for such services and consultation).

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13. No Prior or Other Agreements; Broker Disclaimer. This Sublease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective.

14. Janitorial services (including supplies) shall be provided by Sublessor to Sublessee for a cost of \$2000.00 per month, payable monthly.

15. Sublessee and Sublessor acknowledge that Sublessee may be required to move to operating space within 1515 S. Manchester during the term of the 2 year agreement contemplated by the Sublease. Sublessor and Sublessee agree to cooperate with such move to achieve minimal business disruption to FEI-Zyfer and Odetics, Inc. As of the date of this Sublease, Sublessor and Sublessee have separately agreed on the floor plan of the suitable space for the move to 1515 S. Manchester, should one occur. Sublessor agrees to provide FEI-Zyfer with the space as specified, and to provide tenant improvement, at Sublessor's expense, for adequate power, HVAC, communication, paint and floor coverings to meet normal commercially acceptable standards for the operation of FEI-Zyfer (including executive offices and engineering, manufacturing, administrative and lobby facilities comparable to that existing in the prior premises) in the 1515 S. Manchester facilities should the move be required. Furthermore, Sublessor agrees that any move will not occur prior to four months subsequent to the date the Sublease is entered into by the parties.

16. Sublessee shall be granted access to the gymnasium and cafeteria located in 1515 S. Manchester Ave., Anaheim.

17. Security Deposit: Sublessor shall return $\frac{1}{2}$ of the Security Deposit to Sublessee upon payment of the 12th monthly rental payments due under this Sublease, provided that Sublessee is not in default under any economic obligations under this Sublease beyond any grace or cure period and Sublessor shall return the balance of this Security Deposit to the Sublessee upon receipt of the 24th monthly payment of this Sublease, provided that Sublessee is not in default under any economic obligations under this Sublease beyond any grace or cure period.

18. Since the Master Lease is a net lease of an entire building, the insurance requirements applicable to the tenant are inappropriate as applied to the Sublessee when these provisions are incorporated into the Sublease. Accordingly, Sublessee shall be obligated to insure the contents of it's space (i.e., it's trade fixtures, furniture, and equipment), and that the Sublessor shall be required to maintain the insurance it currently maintains. Sublessee agrees to maintain reasonable liability coverage for occurrence in it's premises, and to name Master Lessor as an additional insured.

19. If Sublessee relocates to 1515 S. Manchester, then prior to such move Sublessor and Sublessee shall enter into a new Sublease with respect to such space and shall submit the Sublease to Master Lessor for its consent, which consent Master Lessor agrees to provide, so long as the new Sublease is substantially similar to this Sublease and there is no Default under the Master Lease. Should Sublessee enter into a new Sublease on 1515 S. Manchester, and if Master Lessor does not require Sublessee to attorn and such Sublease terminates, provided Sublessee is not in Default of such Sublease beyond any grace or cure period, then Sublessee shall be given ninety (90) days from the date of such termination to vacate the Premises, (but Master Lessor shall not assume Sublessor's obligations during said Sublease during said period). During the period that Sublessee occupies the premises of 1585 S. Manchester, and if Master Lessor does not require Sublessee to attorn and such Sublease terminates, provided Sublessee is not in Default of such Sublease beyond any grace or cure period, then Sublessee shall be given sixty (60) days from the date of such termination to vacate the Premises, consistent with the terms provided in the underlying Master Lease (but Master Lessor shall not assume Sublessor's obligations during said Sublease during said period).

20. The following Addendum modifies Paragraph 7.4 of this Sublease. Except that with respect to Paragraphs 30 and 42 of the Master Lease the obligations of Sublessor to the Master Lessor shall also be obligations of Sublessee to the Master Lessor.

21. Sublessee may sublet the premises with the prior consent of Sublessor and Master Lessor, which consent shall not be unreasonably withheld.

22. In the event that all or a portion of 1585 S. Manchester Ave. Building not covered by this Sublease is occupied by someone other than Sublessee the Sublessor agrees at it's expense to modify the facility to provide adequate separation and security for the Sublessee, and the Sublessee shall be granted access to lobby, break-room, and other common areas of that building.

23. If Sublessee has not relocated to 1515 S. Manchester prior to the termination of the Master Lease on 1585 S. Manchester, then this Sublease shall expire concurrent with the expiration of the Master Lease on 1585 S. Manchester in November 2004.

ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION OR BY ANY REAL ESTATE BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS SUBLEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:

1. **SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS SUBLEASE.**
2. **RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING OF THE PROPERTY, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, AND**

THE SUITABILITY OF THE PREMISES FOR SUBLESSEE'S INTENDED USE.

WARNING: IF THE SUBJECT PROPERTY IS LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE SUBLEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PROPERTY IS LOCATED.

Executed at:

on:

Executed at:

on:

By SUBLESSOR:
Odetics, Inc., a Delaware corporation

By SUBLESSEE:
FEI-Zyfer, Inc., a Delaware Corporation

By:

Name Printed: Gregory Miner

Title: Chief Executive Officer

By:

Name Printed:

Title:

By:

Name Printed:

Title:

By:

Name Printed:

Title:

Address: 1515 S. Manchester Ave.

Anaheim, CA 92802

Telephone/Facsimile:

Federal ID No.

Address: 1585 S. Manchester Ave.

Anaheim, CA 92802

Telephone/Facsimile:

Federal ID No.

Consent to the above Sublease is hereby given.

Executed at:

on:

Executed At:

on:

By MASTER LESSOR:
1515 S. Manchester, LLC

By GUARANTOR(S): Frequency Electronics, Inc., a Delaware Corporation

By:

Name Printed: William McFarland

Title:

By:

Name Printed:

Address:

By:

Name Printed:

Title:

By:

Name Printed:

Address:

Address: 18800 Von Karman Ave., Ste. 100
Irvine, CA 92612

Telephone/Facsimile:

Federal ID No.

NOTE: These forms are often modified to meet changing requirements of law and needs of the industry. Always write or call to make sure you are utilizing the most current form: AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION, 700 So. Flower St., Suite 600, Los Angeles, CA 90017. (213) 687-8777.

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Exhibit 21

List of Subsidiaries

Name of Subsidiary	State of Other Jurisdiction of Incorporation or Organization
MAXxess Systems, Inc. formally known as Gyr Inc. incorporated	California
Iteris, Inc., formally known as Odetics ITS, Inc. (63.7% subsidiary of Odetics, Inc.)	Delaware
Broadcast, Inc.	California
Meyer, Mohaddes Associates, Inc. (100% owned subsidiary of Iteris, Inc.)	California
Odetics Europe Limited	England and Wales
Odetics Asia Pacific Pte. Ltd	Singapore
MAXxess EUROPE Ltd (100% owned subsidiary of MAXxess Systems, Inc.)	England and Wales
Zyfer, Inc.	Delaware

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[List of Subsidiaries](#)

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Exhibit 23.1

Consent of Independent Auditors

We consent to the incorporation by reference in the Registration Statements (Form S-3 Nos. 333-100994, 333-99213, 333-90416, 333-40555, 333-63911, 333-66448, 333-66717, 333-69677, 333-74509, 333-74654, 333-91903, 333-88185, 333-40726, 333-46420, 333-65735 and 333-63983) of Odetics, Inc. and in the related Prospectuses, and in the Registration Statements (Form S-8 Nos. 333-75728, 333-05735, 333-44907, 333-30396, 333-90416) of our report dated June 3, 2003 with respect to the consolidated financial statements and schedule of Odetics, Inc. included in this Annual Report (Form10-K) for the year ended March 31, 2003.

/s/ Ernst & Young LLP

Orange County, California
June 23, 2003

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[Consent of Independent Auditors](#)

This certification accompanies this report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934 or incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act, except as shall be expressly set forth by specific reference in such a filing.

**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 Annual Report of Odetics, Inc. (the "Company") on Form 10-K for the fiscal year ended March 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gregory A. Miner, Chief Executive Officer and 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/ GREGORY A. MINER

Gregory A. Miner
*Chief Executive Officer and Chief Financial
Officer*

June 27, 2003

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.

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[CERTIFICATION PURSUANT TO 18 U.S.C. §1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002](#)