



2016



LAUGHING
WATER
CAPITAL

ITERIS[®]



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ITERIS



“Good Co / Bad Co”

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Investment Basics

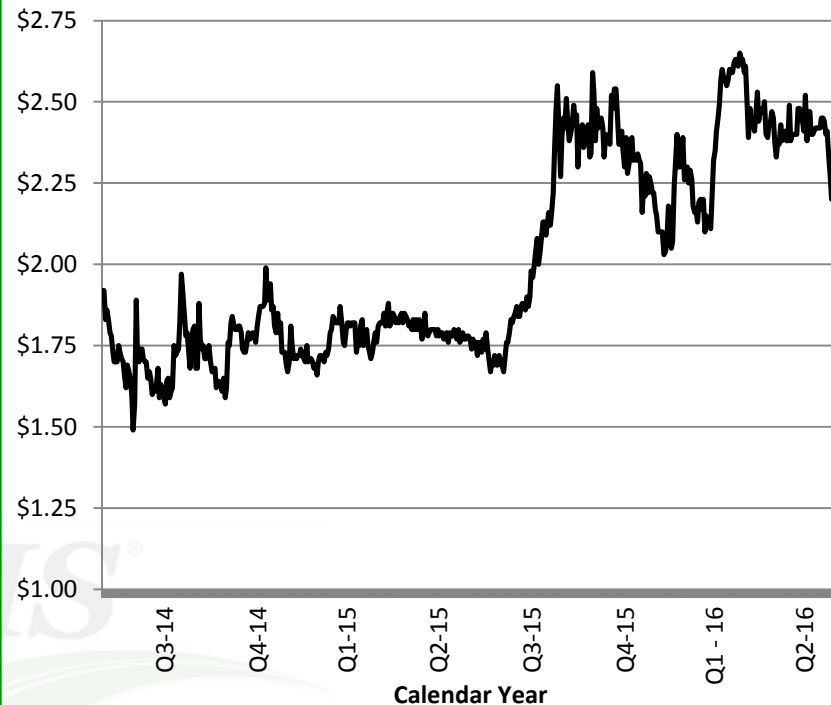
- ✓ Off the Radar Nano Cap
- ✓ Easy To Understand
- ✓ Rock Solid Balance Sheet
- ✓ Secular Tail Winds
- ✓ Competitive Advantages
- ✓ Strong FCF Generation
- ✓ Mis-leading GAAP Financials
- ✓ Large Margin of Safety
- ✓ Lotto Ticket Upside

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Stock Basics

Stock Symbol	ITI
Stock Price	\$2.59*
Shares Out (mm)	32,043
Market Cap (mm)	\$ 82,991
Cash (mm)	\$16,029
Debt (mm)	\$0
Enterprise Value (mm)	\$66,962
% Owned By Insiders	5.2%
Current Yield	N/A
52 Week Range	\$1.67-2.65



Company Overview

- Formed in 1969 as Odetics
- Tech incubator company
- IPO 1989
- Tech bubble darling
- Became Iteris in 2003
- Has owned various businesses over the years before evolving into its current form:

- Iteris is a stable / growing transportation business and a money losing ag-tech business with great potential

“Intelligent Transportation”

Roadway Sensors (“Sensors”)

- Smart traffic management technology
 - Contract manufactured hardware
 - Proprietary software
 - Big data
 - Secular tailwinds

Transportation Systems (“Consulting”)

- Asset light consulting / software business
 - Government outsourcing
 - Proprietary software
 - Big data
 - Secular tailwinds

- **Proper analysis requires disaggregating the 2 businesses**

“Agriculture”

Performance Analytics (“Ag”)

- Precision Agriculture
 - Ground level weather data
 - Increase yields & reduce costs
 - Rooted in transportation-snow removal technology

Why Does the Opportunity Exist?



Big Picture

- GAAP financials don't tell the whole story
 - Two cash flowing businesses, one money losing business
 - On a standalone basis, management believes the 2 cash flowing businesses would generate \$8M in FCF
 - Until recently, the combined company was being run for break even as the Agriculture business was being developed, but is now running at a loss as Ag ramps
 - 450 employees today vs. 300 a year ago
 - R&D expense up 126% vs 2013
- Screens poorly - How many people are peeling back the onion on nano caps?

Segment Reporting

Twelve Months Ended March 31, 2016

	Sensors	Systems	Analytics	Iteris Inc.
Total revenues	40,259	32,330	5,159	77,748
Segment operating income (loss)	7,718	4,031	-7,380	4,369
Corporate and other income (expense), net				-7,479
Amortization of intangible assets				-360
Operating loss				-3,470

Why Does the Opportunity Exist?



Small Picture

Multiple One Time Issues

- 2014 10-K was delayed due to revenue recognition problems
- Stigma of accounting problems are hard to shake off – especially at a nano-cap
- Extra fees tied to audit, consultants and executive search materially impact financials
- Valuation allowance on DTA reflects conservatism
- Screens poorly

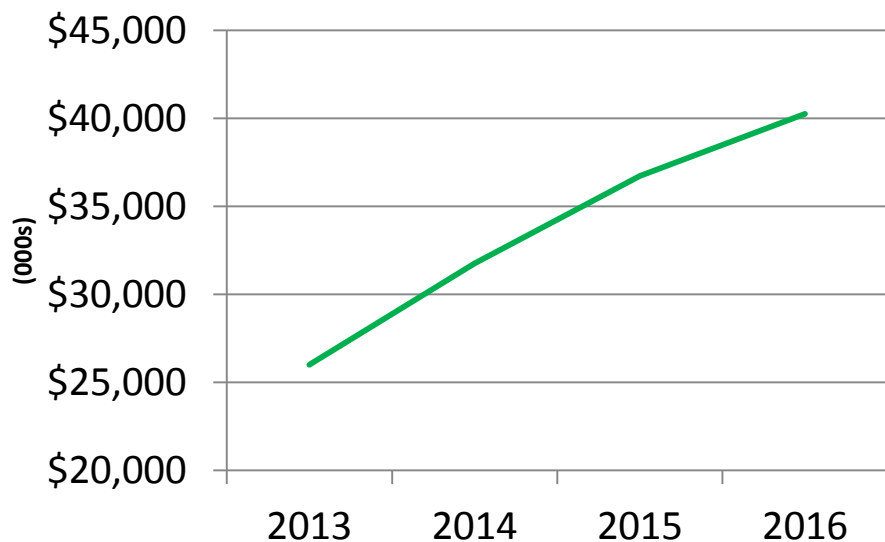
Adjusted Income Statement

	2016	2015	2014
GAAP net loss	\$(12,321)	\$(1,070)	\$1,409
1 Time Operating Adjustments			
Audit Fee overruns	(150)	(941)	-
Quarterly review fee increases	-	(174)	-
Financial consulting service fees	(88)	(768)	-
Executive management severance costs	(150)	(594)	-
Executive management recruiting costs	-	(383)	-
Total Adjustments	(388)	(2,860)	-
Income tax effect on adjustments	147	1,116	-
Total excluded from operating expenses after income tax effect	(241)	(1,745)	-
Other Non Cash Adjustments			
Valuation allowance on DTA	(10,064)	-	-
Non-GAAP net (loss) income	\$ (2,016)	\$ 675	\$1,409

The Core Businesses: “Transportation”

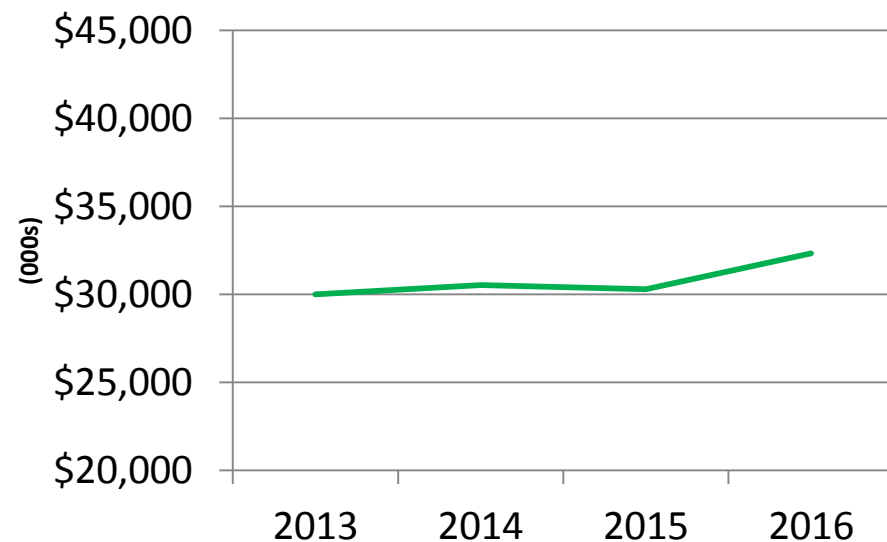
Sensors Revenue

12% CAGR



Systems Revenue

80% YoY Backlog Growth

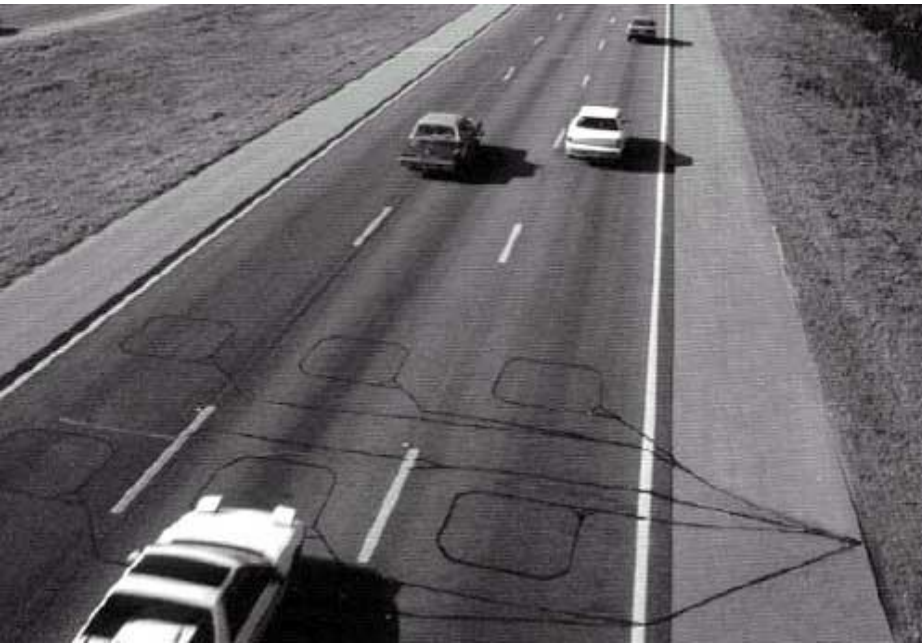


Transportation: Secular Tailwind

Old Technology

Inductive Loop

- Counts cars above a certain weight
- Can trigger traffic lights
- Requires digging up street to install and repair



New Technology

Smart Intersection: Big Data

- Counts cars, motorcycles, bikes, pedestrians
- Re-routes traffic in real time – reduces congestion / emissions
- Identifies collisions
- Optimizes road maintenance
- **Pole mounted cameras are cheap and easy to install and repair**



Transportation Value Proposition



Addressing a Market Need

- Traffic & congestion is a \$140 Billion annual drag on the economy
- 35,000 traffic deaths annually in the U.S.
- 27% of greenhouse gas emissions linked to auto emissions, which are made worse by cars sitting in traffic

Growth & Opportunity

- Sensors revenue up 11% YoY
- Systems revenue up 7% YoY, and should see margin expansion
- Total backlog \$63.3M up 61% YoY
- Large opportunity – ~65% of sensors business is upgrading old systems, 35% greenfield
- Transportation informatics market expected to grow to \$5.1B by 2020 from \$3.9B
- Large opportunity in Government outsourcing

Key Takeaway: Iteris's transportation businesses reduce waste, contribute to economic strength, address societal ills, and are cheaper than the alternative

Competitive Advantage?

Sensors

- Competitive, fragmented market – difficult to claim any “moat”
- Bolt on acquisitions have broadened the offering, making it more attractive
- Relationships matter – long history in the field
- Blue chip customers likely indicate quality
- Taking market share - double digit CAGR vs. 7% industry growth

- Big market - room for lots of players

Competitive Advantage: Sensors

“In the case of Sensors, we continue to grow above average market growth rate. So we're obviously taking market share. And I think that's just due to the fact that we're perceived as the industry leaders. I think the reason that we're the industry leaders, we have the most complete product suite, I think most people believe that we have the strongest products themselves, and then also our sales execution I think is just superior to competition. “

CEO Joe Bergera, Q3'16 Conference Call

Competitive Advantage?

Consulting

- Competitive, fragmented market – difficult to claim any “moat”
- Proprietary software offering
- Relationships matter – long history in the field
- Blue chip customers likely indicate quality
- Backlog up 62% YoY as of Q3’16

- Huge market – room for lots of players

Competitive Advantage: Systems

“Historically, we've seen a lot of expenditures related to transportation infrastructures go into actually building out the roadway infrastructure itself, and at this point increasingly we're seeing investments in intelligent transportation systems and other technology related to connected vehicles or the expectation of connected vehicles. And so that just plays to Iteris' strength, and therefore we're seeing a larger percent of the total available expenditure. So that's I think the driver with respect to Systems.”

CEO Joe Bergera, Q3’16 Conference Call

Transportation Lotto Ticket?

USDOT CVRIA

Iteris is “the keeper of system architecture of connected vehicles for DOT.”

- Leading the development of the **Connected Vehicle Reference Implementation Architecture (CVRIA)**
 - Intersection of OEMs, communication networks, auto electronic manufacturers, etc. inventing the future of transportation
- Hard to imagine there is not a lot of future business attached to connected vehicles
- Impossible to say what this is worth to ITI, but they seem to have a front row seat to the future of transportation

ITER



HANNA BARBERA

Also Worth Noting

Fun Facts

- Historically the Company has not been afraid to repurchase stock: \$5.2M since 2011
 - Not much in dollar terms, but in ex-cash market cap it is significant
- Insiders collectively own 5.2% of the stock, with the CFO, Interim CEO, and 2 board members having bought within the last year
- Pristine balance sheet - \$0 debt, ~\$16M in cash (\$.50 per share)
- Micro cap activist Lloyd Miller is the largest shareholder, with 15.6%
- Awareness is growing: *“Good news for [B. Riley Analyst] we’ve been very busy talking with other banks in terms of getting analyst coverage so [B. Riley Analyst] will have a consensus to work with”*

CFO Andy Schmidt, 2016 B. Riley Investor Conference

What is the Core Business Worth?

Transportation Businesses

- Good businesses, not great
 - + Offer value proposition to customers and have secular tailwinds
 - Dependent on government (dis)function
- 10x steady state should be **minimum** valuation for a growing, nichey business
- Going forward, mid teens multiple should be conservative
 - Strong industry tailwinds
 - Record backlog
 - Margin expansion likely
 - **Above market growth, below market multiple**
 - **Asset light publicly traded consulting businesses trade at P/Es north of 20x**
 - “Connected vehicle” lotto ticket

Transportation Steady State

Free Cash Flow (Million)	\$ 8.0
Multiple	10.0x
Enterprise Value	\$ 80.0
-Debt	0.0
+Cash	16.0
Market Cap	\$ 96.0
Shares	32.0
Per Share	\$ 3.00
Upside	16%

Transportation Go Forward*

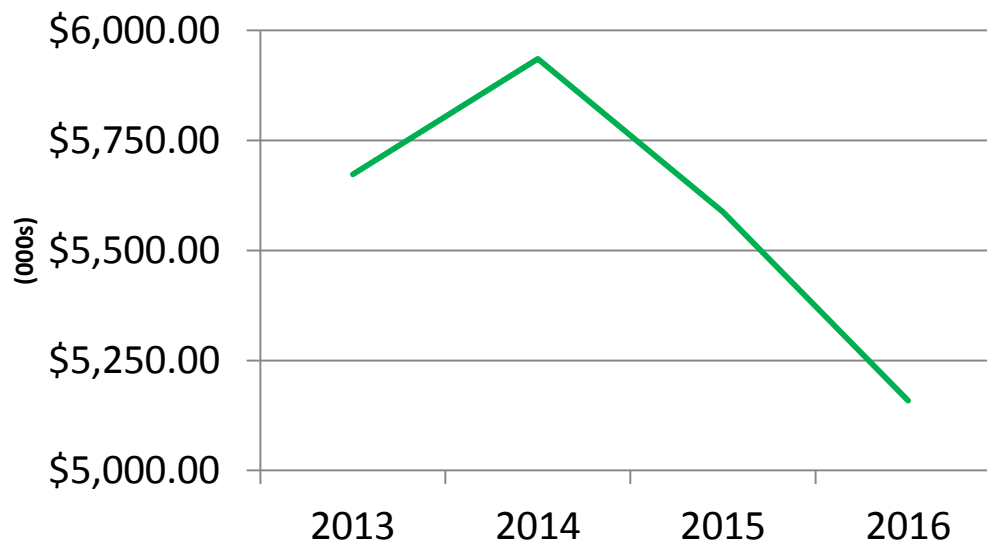
Free Cash Flow (Million)	\$ 7.0	\$ 7.0	\$ 7.0
Multiple	14.0x	16.0x	18.0x
Enterprise Value	\$ 98.0	\$ 112.0	\$ 126.0
-Debt	0.0	0.0	0.0
+Cash	16.0	16.0	16.0
Market Cap	\$ 114.0	\$ 128.0	\$ 142.0
Shares	32.0	32.0	32.0
Per Share	\$ 3.56	\$ 4.00	\$ 4.43
Upside	37%	54%	71%

*continued growth would require working capital, which would reduce FCF

The Speculative Business: Performance Analytics (“Ag”)

Revenue

- Revenues decline as focus shifts from old to new
- Ag Revenue up 19% YoY in Q4'16



Performance Analytics

Agriculture

Agriculture SAAS business growing out of cold weather road maintenance business

Internally funded by transportation business

Predictive analytics & machine learning focusing on weather and agronomy

- Open platform capable of integrating sensor networks & 3rd party models
- Historical weather & soil information back to 1980

Provide guidance for optimal planting, watering, fertilizing, harvesting, pest control etc.

18 issued patents, 28 pending

Target market growing to \$2.3B

Positive: Early Customer Wins

Enterprise: Long customer acquisition process, but 5 out of top 10 crop science companies have signed with ITI.

OEM Channel: Target farm management systems providers, agronomists, supply chain providers, research services

Growers: 2.1 million “farmers” in the U.S. Direct sales to 10k+ acre farmers starting this Q

Negative: Not First to the Gate

Monsanto’s “Climate Corp” has first mover advantage, but farmers don’t like MON

Negative: Lots of \$ Rushing into the Space

- \$4B in recent VC spend
- Not everyone will be a winner

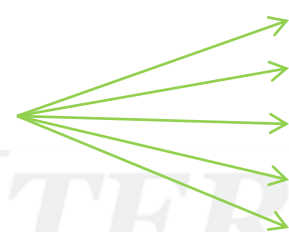
Agriculture Value Proposition

Addressing a Market Need

- Crop yields must double by 2050 to meet growing population demands
- Data driven farming increases row crop yields by 20-50 bushels per acre
- Data driven farming reduces costs for farmers
 - Right sizing water, fertilizer, chemicals, pest control, etc.

Market Opportunity

\$5 Trillion

- 
- 400M U.S. row crop acres
 - Grains
 - Flowers
 - Fruit / nuts
 - International

Key Takeaway: Iteris's products increase revenue and reduce costs for farmers. Difficult to imagine why a farmer would not embrace ag-tech solutions

“Intelligent Planting”

- Predictive analytics identify best present soil temperature and near term future weather conditions to maximize crop yield
 - Plant too early, and yield is reduced by emergence problems and uneven growth
 - Plant too late, and weed-crowding and insect damage risk increases



“Intelligent Fertilizing”

- Monitor and predict wind & rain effect on nutrient leaching
 - How much fertilizer to reapply after heavy rains?
 - Apply more fertilizer on upwind side of field
 - Maximize effectiveness and minimize cost



Agriculture Value Proposition: Irrigation



“Dumb Watering”

- Try to guess how much water crops need based on temperature
- Too much water, and fertilizer costs go up
- Too little water, and root systems are shallow leading to increased risk of weather and disease damage

“Intelligent Watering”

- Predictive analytics monitor temperature, humidity, wind, moisture etc. in real time
- Water is micro-dosed throughout the day to maintain optimum conditions at all times
- Plant health and water uptake are maximized, leading to maximum yields



“Intelligent Crop Maintenance”

- Evaluate past, present, and future temperature and moisture conditions to predict likelihood of pest and disease damage
- Enables cost-effective preventative treatment
- Maximizes yield



Agriculture Value Proposition: Harvest

“Intelligent Harvest”

“[Potato farmers] have to understand the temperature of the soil to actually maximize their harvest. If they harvest too early, they end up with a potato that turns into a potato chip. If they harvest at the right time they end up with a Russet potato that ends up on your table.”

CFO Andy Schmidt, 2016 B. Riley Investor Conference

\$



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What is the Ag Business Worth?



Agriculture Business

- Impossible to value a business like this, but theoretical exercises can be useful
- It is a competitive, fast evolving industry, but it is not *crazy* to think that ClearAg can win 4% of the pie, and this says nothing about enterprise sales or international
- Scalable, recession resistant, recurring revenue SAAS models trade at high P/S multiples at scale
- Management forecasting 80% GMs at scale
- Multiple will grow as revenue grows
 - **LWC expects profits in 4-6 quarters**
 - **Growing transportation business minimizes cash burn**
- Recent comp sales may or may not be relevant, but indicate potential
- Non-zero possibility it is a failure, but the undervalued transportation business means investors are getting this lotto ticket for less than free!

Potential Opportunity*

# of Farms in U.S.	2.1 million
Price Per Farm	\$1,200
Potential Opportunity	\$2.5 billion
Theoretical Future Sales	\$100 million
# of Farms	83,333
% of Total Farms	3.97%

P/Sales*

Sales (000)	\$100,000	\$100,000	\$100,000
Multiple	3.0x	4.0x	5.0x
Value (000)	\$300,000	\$400,000	\$500,000

Upside	380%	540%	700%
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Reality Check

- Management sees growing \$1.2B opportunity
- Comps illustrate value of weather analytics
 - Climate Corp sold to Monsanto for \$1B
 - Weather Corp sold to IBM for \$2B

*LWC estimates

Combined value

Core Transportation Today + Speculative Ag

Core Free Cash Flow (Million)	\$ 7.0	\$ 7.0	\$ 7.0	\$ 7.0	\$ 7.0
Multiple	16.0x	16.0x	16.0x	16.0x	16.0x
Enterprise Value	\$ 112.0	\$ 112.0	\$ 112.0	\$ 112.0	\$ 112.0
-Debt	0.0	0.0	0.0	0.0	0.0
+Cash	16.0	16.0	16.0	16.0	16.0
Core Market Cap	\$ 128.0	\$ 128.0	\$ 128.0	\$ 128.0	\$ 128.0
+ Ag Business	\$ -	\$ 50.0	\$ 100.0	\$ 300.0	\$ 500.0
Total Equity Value	\$ 128.0	\$ 178.0	\$ 228.0	\$ 428.0	\$ 628.0
Shares	32.0	32.0	32.0	32.0	32.0
Per Share	\$ 4.00	\$ 5.56	\$ 7.12	\$ 13.36	\$ 19.60
Upside	54%	115%	175%	416%	657%

The Ag business represents the possibility of a legitimate 10 bagger, **but success with the Ag business is not necessary for a successful investment in ITI.** What is needed is **rational action** by management. If Ag works, GREAT!! If not, cut losses after a reasonable amount of time (2019?) and allow the growing transportation business to shine through. **By 2019 transportation should be worth \$5+ per share.**

What Could Go Wrong

Risks

- Management is too attached to Ag business and it becomes a black hole
- Management does not own much stock, although options incentivize & there has been insider buying
- Intelligent transportation market is up-ended (Waze, etc.)
- Recession / cutbacks to government spending impacts transportation business
- Investment has unknown duration – market is currently focused on the here and now, not what could be in a few years

Mitigants

- Micro cap activist Lloyd Miller owns 15% of the company and would likely reign management in
- New CEO has 1.35M options and new CFO has bought in open market. Old CEO continues to own stock
- Privacy concerns / government access to the inside of your car
- Rock solid balance sheet, history of buying back stock, and spend on ITI technology likely has an above average ROI for government projects
- “The future is never clear, and you pay a very high price in the stock market for a cheery consensus.” ~ Warren Buffett
- Downside is protected



2016



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