

EMRISE Corp  
Form 10-Q  
May 13, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended March 31, 2013**

**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 1-10346**

**EMRISE CORPORATION**

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(Exact name of registrant as specified in its charter)

|                                                                   |                                         |
|-------------------------------------------------------------------|-----------------------------------------|
| <b>Delaware</b>                                                   | <b>77-0226211</b>                       |
| (State or other jurisdiction of<br>incorporation or organization) | (I.R.S. Employer<br>Identification No.) |

**2530 Meridian Parkway**

**Durham, North Carolina 27713**

(Address of principal executive offices) (Zip code)

**(408) 200-3040**

(Registrant's telephone number, including area code)

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

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

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

|                                                  |                                                               |
|--------------------------------------------------|---------------------------------------------------------------|
| Large Accelerated Filer <input type="checkbox"/> | Accelerated Filer <input type="checkbox"/>                    |
| Non-Accelerated Filer <input type="checkbox"/>   | Smaller Reporting Company <input checked="" type="checkbox"/> |
| (Do not check if a smaller reporting company)    |                                                               |

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

The number of shares outstanding of the Registrant's common stock, \$0.0033 par value, as of May 9 , 2013 was 10,698,337.

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## PART I — FINANCIAL INFORMATION

## ITEM 1. Financial Statements.

**EMRISE CORPORATION****Condensed Consolidated Balance Sheets**

(in thousands, except share and per share amounts)

|                                                                                                                      | March 31, 2013<br>(unaudited) | December 31, 2012 |
|----------------------------------------------------------------------------------------------------------------------|-------------------------------|-------------------|
| <b>ASSETS</b>                                                                                                        |                               |                   |
| Current assets:                                                                                                      |                               |                   |
| Cash and cash equivalents                                                                                            | \$ 1,079                      | \$ 1,519          |
| Accounts receivable, net of allowances for doubtful accounts of \$67 at March 31, 2013 and \$75 at December 31, 2012 | 7,344                         | 6,784             |
| Other receivables                                                                                                    |                               |                   |
| Inventories                                                                                                          | 6,518                         | 7,255             |
| Current deferred tax assets                                                                                          | 120                           | 128               |
| Prepaid and other current assets                                                                                     | 674                           | 1,138             |
| Total current assets                                                                                                 | 15,735                        | 16,824            |
| Property, plant and equipment, net                                                                                   | 3,812                         | 973               |
| Goodwill                                                                                                             | 4,913                         | 5,146             |
| Intangible assets other than goodwill, net                                                                           | 527                           | 584               |
| Deferred tax assets                                                                                                  | 55                            | 59                |
| Restricted cash                                                                                                      | -                             | 407               |
| Other assets                                                                                                         | 413                           | 405               |
| Total assets                                                                                                         | \$ 25,455                     | \$ 24,398         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                          |                               |                   |
| Current liabilities:                                                                                                 |                               |                   |
| Accounts payable                                                                                                     | \$ 3,634                      | \$ 2,970          |
| Accrued expenses                                                                                                     | 3,832                         | 3,759             |
| Lines of credit                                                                                                      | 804                           | 1,122             |
| Current portion of long-term debt                                                                                    | 995                           | 942               |
| Income taxes payable                                                                                                 | 428                           | 307               |
| Other current liabilities                                                                                            | 275                           | 274               |
| Total current liabilities                                                                                            | 9,968                         | 9,374             |
| Long-term debt                                                                                                       | 4,712                         | 3,033             |
| Other liabilities                                                                                                    | 897                           | 896               |
| Total liabilities                                                                                                    | 15,577                        | 13,303            |
| Commitments and contingencies                                                                                        | -                             | -                 |

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Stockholders' equity:

|                                                                                                                                                 |           |           |   |   |
|-------------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|---|---|
| Preferred stock, \$0.01 par value. Authorized 10,000,000 shares; no shares issued and outstanding                                               | -         | -         |   |   |
| Common stock, \$0.0033 par value. Authorized 75,000,000 shares; 10,698,337 issued and outstanding at both March 31, 2013 and December 31, 2012. | 128       | 128       |   |   |
| Additional paid-in capital                                                                                                                      | 44,177    | 44,177    |   |   |
| Accumulated deficit                                                                                                                             | (32,060)  | (31,532)  | ) | ) |
| Accumulated other comprehensive loss                                                                                                            | (2,367)   | (1,678)   | ) | ) |
| Total stockholders' equity                                                                                                                      | 9,878     | 11,095    |   |   |
| Total liabilities and stockholders' equity                                                                                                      | \$ 25,455 | \$ 24,398 |   |   |

*The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements*

**EMRISE CORPORATION****Condensed Consolidated Statements of Operations and Comprehensive Loss**

(Unaudited)

(in thousands, except per share amounts)

|                                            | Three Months<br>Ended<br>March 31, |           |
|--------------------------------------------|------------------------------------|-----------|
|                                            | 2013                               | 2012      |
| Net sales                                  | \$7,691                            | \$7,539   |
| Cost of sales                              | 5,414                              | 5,430     |
| Gross profit                               | 2,277                              | 2,109     |
| Operating expenses:                        |                                    |           |
| Selling, general and administrative        | 2,350                              | 2,363     |
| Engineering and product development        | 295                                | 339       |
| Total operating expenses                   | 2,645                              | 2,702     |
| Loss from operations                       | (368 )                             | (593 )    |
| Other income (expense):                    |                                    |           |
| Interest income                            | 21                                 | 12        |
| Interest expense                           | (118 )                             | (91 )     |
| Other, net                                 | 103                                | (78 )     |
| Total other expense, net                   | 6                                  | (157 )    |
| Loss before income taxes                   | (362 )                             | (750 )    |
| Income tax expense                         | 166                                | 112       |
| Loss from continuing operations            | (528 )                             | (862 )    |
| Discontinued operations:                   |                                    |           |
| (Loss)/Income from discontinued operations | -                                  | (9 )      |
| Tax provision on discontinued operations   | -                                  | -         |
| (Loss)/Income from discontinued operations | -                                  | (9 )      |
| Net loss                                   | \$(528 )                           | \$(871 )  |
| Weighted average shares outstanding        |                                    |           |
| Basic                                      | 10,698                             | 10,668    |
| Diluted                                    | 10,698                             | 10,668    |
| Loss per share:                            |                                    |           |
| Basic                                      |                                    |           |
| Continuing operations                      | \$(0.05 )                          | \$(0.08 ) |
| Discontinued operations                    | \$-                                | \$-       |
| Net loss                                   | \$(0.05 )                          | \$(0.08 ) |
| Diluted                                    |                                    |           |
| Continuing operations                      | \$(0.05 )                          | \$(0.08 ) |
| Discontinued operations                    | \$-                                | \$-       |
| Net loss                                   | \$(0.05 )                          | \$(0.08 ) |

Statement of Comprehensive Loss

|                                         |            |          |
|-----------------------------------------|------------|----------|
| Net loss                                | \$(528 )   | \$(871 ) |
| Foreign currency translation adjustment | \$(689 )   | \$472    |
| Comprehensive loss                      | \$(1,217 ) | \$(399 ) |

*The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements*

**EMRISE CORPORATION****Condensed Consolidated Statements of Cash Flows**

(Unaudited)

(in thousands)

|                                                                 | Three Months<br>Ended<br>March 31, |          |
|-----------------------------------------------------------------|------------------------------------|----------|
|                                                                 | 2013                               | 2012     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                    |                                    |          |
| Net loss                                                        | \$(528 )                           | \$(871 ) |
| Adjustments to arrive at net loss from continuing operations    | -                                  | 9        |
| Net loss from continuing operations                             | \$(528 )                           | \$(862 ) |
| Reconciliation to net cash provided by operating activities:    |                                    |          |
| Depreciation and amortization                                   | 115                                | 100      |
| Loss on sale of property, plant & equipment                     | 3                                  | -        |
| Provision for doubtful accounts                                 | 28                                 | 93       |
| Provision for warranty reserve                                  | 50                                 | 57       |
| Provision for inventory reserve                                 | 236                                | 307      |
| Provision for income taxes                                      | 109                                | (14 )    |
| Amortization of debt (premium) discount                         | -                                  | (45 )    |
| Stock-based expense                                             | -                                  | 7        |
| Changes in assets and liabilities:                              |                                    |          |
| Accounts receivable                                             | (585 )                             | 1,374    |
| Inventories                                                     | 317                                | (909 )   |
| Prepaid and other assets                                        | 863                                | 297      |
| Accounts payable and accrued expenses                           | 716                                | 9        |
| Operating cash flow generated in continuing operations          | 1,324                              | 414      |
| Net cash generated in operating activities                      | 1,324                              | 414      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                    |                                    |          |
| Purchases of property, plant and equipment                      | (2,976)                            | (150 )   |
| Investing cash flow used in continuing operations               | (2,976)                            | (150 )   |
| Net proceeds from sale of discontinued operations               | -                                  | 300      |
| Net cash (used in) provided by investing activities             | (2,976)                            | 150      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                    |                                    |          |
| Building mortgage                                               | 2,124                              | -        |
| Net borrowings from lines of credit                             | -                                  | 271      |
| Repayments of lines of credit                                   | (337 )                             | -        |
| Repayments of long-term debt                                    | (394 )                             | (504 )   |
| Financing cash flow provided by (used in) continuing operations | 1,393                              | (233 )   |
| Effect of exchange rate changes on cash                         | (181 )                             | 339      |
| Net (decrease) increase in cash and cash equivalents            | (440 )                             | 670      |

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|                                                  |         |         |
|--------------------------------------------------|---------|---------|
| Cash and cash equivalents at beginning of period | 1,519   | 805     |
| Cash and cash equivalents at end of period       | \$1,079 | \$1,475 |

SUPPLEMENTAL DISCLOSURES OF NON-CASH  
INVESTING AND FINANCING ACTIVITIES:

Acquisition of equipment through capital lease \$53 \$-

*The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements*

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**EMRISE CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Organization and Business*

EMRISE Corporation (the “Company”) designs, manufactures and markets proprietary electronic devices and communications equipment for aerospace, defense, industrial, and communications applications. The Company currently has operations in the United States, England and France. The Company conducts its business through two operating segments: electronic devices and communications equipment. The subsidiaries within the electronic devices segment design, develop, manufacture and market electronic devices for defense, aerospace and industrial markets and operate out of facilities located in England. The subsidiaries within the communications equipment segment design, develop, manufacture and market network access equipment, including network timing and synchronization products and operate out of facilities located in both the United States and France.

*Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission (the “SEC”) and therefore do not include all information and footnotes necessary for a complete presentation of the financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States (“GAAP”). The year-end balance sheet was derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements. The unaudited condensed consolidated financial statements do, however, reflect all adjustments, consisting of only normal recurring adjustments, which are, in the opinion of management, necessary to state fairly the financial position as of March 31, 2013 and the results of operations and cash flows for the related interim periods ended March 31, 2012, and 2013. However, these results are not necessarily indicative of results for any other interim period or for the year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the SEC on March 29, 2013.

*Comprehensive Loss*

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Comprehensive loss includes all changes in equity during a period except those that resulted from investments by or distributions to the Company's stockholders. Other comprehensive income (loss) refers to revenues, expenses, gains and losses that, under GAAP, are included in comprehensive loss, but excluded from net income (loss), as these amounts are recorded directly as an adjustment to stockholders' equity. The Company's other comprehensive income (loss) consists of foreign currency translation adjustments.

### *Product Warranty Liabilities*

Generally, the Company's products carry a standard one-year, limited parts and labor warranty. In certain circumstances, the Company provides a two-year, limited parts and labor warranty on communications test instruments and network access products. The Company offers extended warranties beyond two years for an additional cost to its customers. Products returned under warranty typically are tested and repaired or replaced at the Company's option. Historically, the Company has not experienced significant warranty costs or returns.

The Company records a liability for estimated costs that it expects to incur under the basic limited warranties when product revenue is recognized. Factors affecting the warranty liability include the number of units sold, historical and anticipated rates of claim and costs per claim. The Company periodically assesses the adequacy of its warranty liability accrual based on changes in these factors.

### *Loss per Share from Continuing Operations*

Basic loss per share from continuing operations is computed by dividing net loss from continuing operations by the weighted average common shares outstanding during a period. Diluted loss per share from continuing operations is based on the treasury stock method and includes the dilutive effect of stock options and warrants outstanding during the period. Common share equivalents have been excluded where their inclusion would be anti-dilutive. As a result of the losses from continuing operations incurred by the Company for the three months ended March 31, 2013 and 2012, the potentially dilutive common shares have been excluded from the loss per share computation because their inclusion would have been anti-dilutive. The following table illustrates the computation of basic and diluted loss per share from continuing operations (in thousands, except per share amounts):

|                                                  | Three Months Ended<br>March 31, |           |
|--------------------------------------------------|---------------------------------|-----------|
|                                                  | 2013                            | 2012      |
| NUMERATOR:                                       |                                 |           |
| Net loss                                         | \$ (528 )                       | \$ (871 ) |
| Less: income from discontinued operations        | -                               | (9 )      |
| Net loss from continuing operations              | \$ (528 )                       | \$ (862 ) |
| DENOMINATOR:                                     |                                 |           |
| Basic weighted average common shares outstanding | 10,698                          | 10,668    |

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|                                                             |           |           |
|-------------------------------------------------------------|-----------|-----------|
| Diluted weighted average common shares outstanding          | 10,698    | 10,668    |
| Basic and diluted loss per share from continuing operations | \$(0.05 ) | \$(0.08 ) |

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**EMRISE CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The following table shows the common stock equivalents that were outstanding as of March 31, 2013 and 2012, respectively, but were not included in the computation of diluted earnings per share because the options' or warrants' exercise price was greater than the average market price of the common shares, and therefore, the effect would have been anti-dilutive:

|                                      | Number of<br>Shares | Range of<br>Exercise Price<br>Per Share |
|--------------------------------------|---------------------|-----------------------------------------|
| Anti-dilutive common stock options:  |                     |                                         |
| As of March 31, 2013                 | 402,282             | \$0.55 – \$7.50                         |
| As of March 31, 2012                 | 513,000             | \$1.31 – \$7.50                         |
| Anti-dilutive common stock warrants: |                     |                                         |
| As of March 31, 2013                 | -                   | -                                       |
| As of March 31, 2012                 | 8,000               | \$4.31                                  |

*Revenue Recognition*

The Company derives revenues from sales of electronic devices and communications equipment products. The Company's sales are based upon written agreements or purchase orders that identify the type and quantity of the items being purchased and the purchase price.

*Communications Equipment-* The Company recognizes revenues from its communications equipment business segment based in France and the U.S. at the point of shipment of those products. An estimate of warranty cost is recorded at the time the revenue is recognized. Customer discounts are included in the product price list provided to the customer. Product returns are infrequent and require prior authorization because sales are final and the Company tests its products for quality prior to shipment to ensure products meet the specifications of the binding purchase orders under which those products are shipped. Normally, when a customer requests and receives authorization to return a product, the request is accompanied by a purchase order for a repair or for a replacement product for which the customer pays.

*Electronic Devices-* The Company's subsidiaries in England comprise the electronic devices segment of the business. Revenue recognition for products and services provided by the Company's subsidiaries in England depends upon the type of contract involved. Engineering/design services contracts generally entail design and production of a prototype

over a term of up to several years, with revenue recognized over the term of the contract on a percentage of completion basis. Production contracts provide for a specific quantity of products to be produced over a specific period of time. Customers issue binding purchase orders or enter into binding agreements for the products to be produced. The Company recognizes revenues on these orders as the products are shipped. Returns are infrequent and permitted only with prior authorization because these products are custom made to order based on binding purchase orders and are quality tested prior to shipment. An estimate of warranty cost is recorded at the time revenue is recognized. The Company offers extended warranty contracts for an additional cost to its customers, which are recognized ratably over the term of the extended warranty contract.

Revenues from services such as repairs and modifications are recognized when the service is completed and invoiced. For repairs that involve shipment of a repaired product, the Company recognizes repair revenues when the product is shipped back to the customer. Service revenues contribute less than 5% of total revenue and, therefore, are considered to be immaterial to overall financial results.

#### *Foreign Currency Instruments*

The Company evaluates the impact of currency fluctuations on a periodic basis and, from time to time, participates in currency hedging activities when the need arises. The Company currently uses foreign currency forward contracts, which do not meet hedge accounting requirements, to manage currency exposures related to foreign operation sales in U.S. dollars. These instruments are generally short-term in nature, with typical maturities of less than one year, and are subject to fluctuations in foreign exchange rates. The Company adjusts the value of the hedging instruments at the end of the reporting period to reflect the market value of the instrument.

#### *Recently Adopted Accounting Pronouncements*

In February 2013 the FASB issued ASU 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The ASU requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified. This ASU is effective prospectively for reporting periods beginning after December 15, 2012. Its adoption of ASU 2013-02 is not expected to have any material impact on its consolidated financial statements.

## **EMRISE CORPORATION**

### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

#### **NOTE 2 — LIQUIDITY**

The Company's liquidity is closely monitored by management. The Company uses cash flow forecasting linked to production forecasts and existing and projected credit and bank facilities, to ensure there are sufficient financial resources to fulfill its short-term needs and strategic plans. The Company has a long term bank facility in the UK with Lloyds TSB which extends to August 2016, a 20 year mortgage of \$2.2 million also with Lloyds TSB, and has issued promissory notes to the former shareholders of ACC, a business purchased by the Company in 2008, totaling \$2.9 million on which the final payment is not due until December 2014. The UK term loan from Lloyds TSB has a covenant that links to the net worth of the Company. Further details of these borrowings are set out below.

Short-term credit facilities are heavily dependent upon the sales and underlying profitability of the Company's subsidiaries. Credit facilities for the operating subsidiaries are a function of accounts receivable. The Company reported working capital of \$5.8 million at March 31, 2013 compared with \$7.5 million at December 31, 2012. The reduction reflects the property purchased in March 2013 through a combination of cash and a new \$2.1 million mortgage facility and a \$0.3 million repayment of promissory notes. There are no additional major capital expenditure plans anticipated in 2013 which would absorb working capital; management considers that the current level of working capital is adequate for the Company's current requirements. The majority of the Company's cash is held by its foreign subsidiaries. There are limitations on the amounts that may be repatriated for use in paying corporate expenses and paying corporate debt. The overseas companies pay management charges to the parent Company for management services and brand name use and also pay dividends if and when appropriate.

The Company recognizes the need to closely manage cash from operations to meet the operational needs of the business and satisfy near-term debt service obligations. As a result of the combination of forecasted cash flows from operations and existing financing arrangements, the Company believes it has sufficient funding to support its working capital requirements during the next 12 months. The Company has a substantial backlog as of March 31, 2013, and the Company continues to experience good booking levels to support future shipments. In order to support future growth, the Company will reinvest a substantial amount of cash from operations back into the business for inventory purchases, engineering and product development. The Company's ability to support its business plan is dependent upon its ability to achieve profitable operations, manage costs and satisfy long-term debt service obligations. Taking these factors into consideration, management believes the Company will be able to satisfy its long-term debt service obligations for the next twelve months from the date of issuance of these financial statements, and meet its short term obligations and commitments.

#### **NOTE 3 — DISCONTINUED OPERATIONS**

*Test Product Line*

During the fourth quarter of 2011, CXR Larus Corporation (“CXR Larus”), a wholly-owned subsidiary of the Company, committed to the sale of certain assets relating solely to the CXR Larus product line of telecommunications test equipment (the “Test Product Line”). The sale of these assets was completed on February 7, 2012. The Test Product Line was previously included in the Company’s communications equipment segment and was accounted for as an asset held for sale as of December 31, 2011.

There were no test equipment assets or liabilities remaining at March 31, 2012 or 2013.

The following table summarizes certain components of the statements of operations for discontinued operations for the Test Product Line for the three months ended March 31, 2012 (in thousands):

|                                      | <b>2012</b> |
|--------------------------------------|-------------|
| Net Sales                            | \$-         |
| Income (loss) from operations        | \$-         |
| Loss on sale                         | (9     )    |
| Provision for income taxes           | -           |
| Net (loss) income                    | \$(9     )  |
| (Loss) earnings per share:           |             |
| Basic and diluted                    | \$-         |
| Weighted average shares outstanding: |             |
| Basic and diluted                    | 10,668      |

**EMRISE CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 4 — STOCK-BASED COMPENSATION**

The Company has five stock option plans, the following two of which, continue to be available and these are described more fully in the Company's Annual Report on Form 10-K for the year ended December 31, 2012:

Amended and Restated 2000 Stock Option Plan; and  
2007 Stock Incentive Plan.

The Company's board of directors (the "Board") does not intend to issue any additional options under the Amended and Restated 2000 Stock Option Plan.

Total stock-based compensation expense included in wages, salaries and related costs was \$3,000 for the three months ended March 31, 2013 and \$7,000 for the three months ended March 31, 2012. These compensation expenses were charged to selling, general and administrative expenses. As of March 31, 2013, the Company had a \$16,000 unrecognized compensation expense related to stock option grants, which will be recognized over the remaining weighted average period of ten months

No restricted stock was awarded under the 2007 Stock Incentive Plan to the members of the Board during the period. There was no charge recorded for restricted stock compensation expense during the three months ended March 31, 2013.

**NOTE 5 — OPERATING SEGMENTS**

The Company has two operating segments: electronic devices and communications equipment. The electronic devices segment manufactures and markets electronic power supplies, radio frequency ("RF") and microwave devices and subsystem assemblies. The electronic devices segment consists of the Company's two electronic device subsidiaries located in England, Pascall Electronics Limited ("Pascall") and XCEL Power Systems Limited ("XCEL"), both of which offer the same or similar products to the same or similar customers. The communications equipment segment designs, manufactures and distributes network access products and timing and synchronization products. The communications

equipment segment consists of operating entities CXR Larus, which is located in the United States, and CXR Anderson Jacobson (“CXR AJ”), which is located in France, both of which offer the same or similar products to similar customers. Both segments sell primarily in the U.S. and European markets, but they have distinctly different customers, design and manufacturing processes and marketing strategies. Each segment has discrete financial information and a separate management structure.

The Company evaluates performance based upon contribution margin of the segments and also upon profit or loss from operations before income taxes exclusive of nonrecurring gains and losses. The Company accounts for inter-segment sales at pre-determined prices negotiated between the individual segments.

Selected financial data for each of the Company’s operating segments reconciled to the consolidated totals is shown below (in thousands):

|                               | Three Months Ended     |           |
|-------------------------------|------------------------|-----------|
|                               | March 31,              |           |
|                               | 2013                   | 2012      |
| Net sales                     |                        |           |
| Electronic devices            | \$5,509                | \$ 5,416  |
| Communications equipment      | 2,182                  | 2,123     |
| Total net sales               | \$7,691                | \$ 7,539  |
| Operating income (loss)       |                        |           |
| Electronic devices            | \$625                  | \$ 575    |
| Communications equipment      | (256 )                 | (305 )    |
| Corporate and other           | (737 )                 | (863 )    |
| Total operating income (loss) | \$(368 )               | \$ (593 ) |
|                               | March 31, December 31, |           |
|                               | 2013                   | 2012      |
| Total assets                  |                        |           |
| Electronic devices            | \$19,177               | \$ 17,222 |
| Communications equipment      | 6,110                  | 7,018     |
| Corporate and other           | 168                    | 158       |
| Total assets                  | \$25,455               | \$ 24,398 |

**EMRISE CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 6 — ACCOUNTS RECEIVABLE**

The Company's accounts receivable result from sales to a broad customer base. The Company extends credit to its customers based upon an evaluation of the customer's financial condition and credit history and generally does not require collateral. Accounts receivable are generally due within 30 days in the Company's U.S. and French operations and 60 days in its English operations and are stated net of an allowance for doubtful accounts. Accounts outstanding for longer than the contractual payment terms are considered past due. Provisions for uncollectible accounts are made based on the Company's specific assessment of the collectability of all past due accounts. Credit losses are provided for in the financial statements and consistently have been within management's expectations. The Company carries insurance to cover accounts receivable derived from export sales from the United Kingdom. Two customers accounted for 12.4% and 12.7% of total sales in the quarter to March 31, 2013, and these customers accounted for 14.8% and 12.2% of total accounts receivable at the period end. These amounts have been received since the period end. No single customer represented ten percent or more of the Company's total net sales during three months ended March 31, 2012. There was no single customer that accounted for more than ten percent of the net accounts receivable at December 31, 2012. The following table reflects the changes in the Company's doubtful accounts reserve during the three months ended March 31, 2013 (in thousands):

|                                     |      |
|-------------------------------------|------|
| Balance at December 31, 2012        | \$75 |
| Additional reserve for three months | -    |
| Recoveries                          | -    |
| Accounts receivable written off     | (6 ) |
| Foreign currency translation        | (2 ) |
| Balance at March 31, 2013           | \$67 |

**NOTE 7 — INVENTORIES**

Inventories are stated at the lower of cost (first-in, first-out method) or market (net realizable value) and consisted of the following (in thousands):

|               | March<br>31,<br>2013 | December 31,<br>2012 |
|---------------|----------------------|----------------------|
| Raw materials | \$3,295              | \$ 3,383             |

|                   |         |          |
|-------------------|---------|----------|
| Work-in-progress  | 1,303   | 1,600    |
| Finished goods    | 1,920   | 2,272    |
| Total inventories | \$6,518 | \$ 7,255 |

#### **NOTE 8- PROPERTY, PLANT AND EQUIPMENT**

On March 4, 2013, the Company purchased the property occupied by its UK subsidiary Pascall, which it previously occupied through a lease. The lease had been due to expire in 2016. The cost of the property was £1.8 million (approximately \$2.7 million at the rate of exchange prevailing at March 31, 2013). In order to finance this purchase the Company secured a new 20 year loan from Lloyds TSB plc for £1.4 million (approximately \$2.1 million) at an annual rate of interest fixed at 4.8% for 15 years. Thereafter, the interest reverts to a rate linked to the London Inter-bank lending rate. The balance of the purchase price of \$0.6 million was financed using the Company's cash.

**EMRISE CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 9 — GOODWILL**

The following table reflects changes in our goodwill balances for the three months ended March 31, 2013 (in thousands):

|                              |         |
|------------------------------|---------|
| Balance at December 31, 2012 | \$5,146 |
| Foreign currency translation | (233 )  |
| Balance at March 31, 2013    | \$4,913 |

The goodwill all relates to the electronic devices segment of the business.

**NOTE 10 — INTANGIBLE ASSETS OTHER THAN GOODWILL**

The following table reflects changes in intangible assets (other than goodwill), balances for the three months ended March 31, 2013 (in thousands):

|                              |       |
|------------------------------|-------|
| Balance at December 31, 2012 | \$584 |
| Amortization                 | (34 ) |
| Foreign currency translation | (23 ) |
| Balance at March 31, 2013    | \$527 |

The intangible assets constitute trademarks, trade names and technology acquired.

**NOTE 11— INCOME TAXES**

The Company files a consolidated U.S. federal income tax return. State tax returns in the state jurisdictions of California, Texas, Pennsylvania and New Jersey are filed on a consolidated, combined or separate basis depending on the applicable laws relating to the Company and its domestic subsidiaries. Additionally, the Company's subsidiaries files tax returns in England and France. The Company provides for income taxes at the end of each interim period based on the estimated effective tax rate adjusted for certain discreet items for the full fiscal year. Cumulative adjustments to the Company's estimate are recorded in the interim period in which a change in the estimated annual effective rate is determined.

The effective tax rate is subject to significant volatility on a consolidated basis, because the profits of the Company's subsidiaries in England are subject to income tax at the local statutory rate of 23.25% and the Company's subsidiary in France is subject to income tax at the local statutory rate of 33%. The tax loss carry-forwards of the U.S. entities are not available for offset against the profits of the overseas subsidiaries. The Company has minimal tax liabilities in the U.S. because it has not generated taxable profits in the United States. The tax charges in the three months ended March 31, 2013 and the three months ended March 31, 2012, are entirely attributable to the taxable profits generated by the Company's U.K. subsidiaries. The first quarter profits generated in the UK in 2013 and 2012 were \$0.6 million and \$0.4 million respectively.

The Company's business is subject to regulation under a wide variety of United States federal, state and foreign tax laws, regulations and policies. The majority of the Company's foreign subsidiaries have earnings and profits that are reinvested indefinitely. However, the foreign subsidiaries have previously issued guarantees on a financing agreement held by the Company and, as a result, under Internal Revenue Code Section 956, have been deemed to have distributed these earnings to fund U.S. operations. This has resulted in U.S. federal taxable income and an increase in U.S. tax liability, which has been reduced through utilization of available net operating loss carry-forwards and foreign tax credits. The Company has utilized a significant portion of its net operating losses available to be carried forward into future periods and, as a result, income from operations and/or gain on sales of assets could result in tax obligations.

As of March 31, 2013, the Company had not recorded any net unrecognized tax benefits. The Company currently has no open matters with tax authorities nor is it engaged in an examination by any tax authority. The Company recognizes interest and penalties related to uncertain tax positions in interest expense and selling, general and administrative expense, respectively, in the condensed consolidated statements of operations and comprehensive income. No interest or penalties were recognized during the three months ended March 31, 2013. As of March 31, 2013, the Company had no accrual for interest or penalties.

The Company is no longer subject to United States federal and state tax examinations for years before 2009 and 2008 respectively, and is no longer subject to tax examinations for the United Kingdom for years prior to 2011, and for France for years prior to 2009.

**EMRISE CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 12 — FINANCING ARRANGEMENTS**

The Company has a variety of debt and credit facilities to satisfy the financing requirements of its operations and the countries within which it operates. These arrangements are tabulated below.

*All amounts are in \$ thousands*

|                                   | March<br>31,<br>2013 | December<br>31, 2012 |
|-----------------------------------|----------------------|----------------------|
| Lines of credit                   |                      |                      |
| Lloyds TSB Commercial Finance     | 518                  | 37                   |
| FACTOCIC                          | 216                  | 964                  |
| Bridge Bank                       | 70                   | 121                  |
| Lines of credit                   | \$ 804               | \$ 1,122             |
|                                   |                      |                      |
|                                   | March<br>31,<br>2013 | December<br>31, 2012 |
| Long-term debt                    |                      |                      |
| Lloyds term loan                  | 819                  | 928                  |
| Lloyds Mortgage                   | 2,124                | -                    |
| Promissory Notes payable          | 2,577                | 2,877                |
| Capital lease obligations         | 187                  | 170                  |
|                                   | 5,707                | 3,975                |
| Current portion of long-term debt | (995 )               | (942 )               |
| Long-term debt                    | \$4,712              | \$ 3,033             |

*Details of the borrowings set out in the table above are explained below.*

**Lloyds TSB Commercial Finance**

On August 31, 2010, two of the Company's UK subsidiaries, Pascall and XCEL, each entered into a Receivables Finance Agreement with Lloyds TSB Commercial Finance ("Lloyds") (each, a "Receivables Finance Agreement" and, collectively, the "Receivables Finance Agreements"), pursuant to which Lloyds agreed to provide Pascall and XCEL a credit facility to support their UK operations in the aggregate principal amount of £2.75 million (\$4.2 million based on the exchange rate on March 31, 2013), in each case at an advance rate of 88%, a discount charge of 2.5% above the base rate, and a service fee of 0.2%. The Receivables Finance Agreement between Pascall and Lloyds is secured by the All Assets Debenture, dated August 31, 2010, given by Pascall in favor of Lloyds (the "Pascall Debenture") and the Receivables Finance Agreement between XCEL and Lloyds is secured by the All Assets Debenture, dated August 31, 2010, given by XCEL in favor of Lloyds (the "XCEL Debenture"). The Receivables Finance Agreements bear interest at the prevailing London interbank lending rate (currently 0.5%) plus 2.5% on the outstanding balance which is paid monthly. As of March 31, 2013, outstanding borrowings under the Receivable Finance Agreements were \$518,000.

## **FACTOCIC**

On September 20, 2010, the Company's French subsidiary, CXR AJ, entered into an accounts receivable financing arrangement with FACTOCIC S.A., a subsidiary of CIC Group ("CIC") (the "CIC Agreement"), pursuant to which CIC agreed to provide CXR AJ a financing arrangement to support its French operations at an advance rate of 90% of presented receivables. The CIC Agreement bears interest at the three month EURIBOR (currently 0.5%) plus 1.4%. As of March 31, 2013, CXR AJ had \$216,000 of outstanding borrowings under the CIC Agreement.

## **Bridge Bank**

On November 15, 2010, CXR Larus and Bridge Bank, National Association ("Bridge Bank") executed a Business Financing Agreement, dated as of October 22, 2010 (the "Business Financing Agreement"), pursuant to which Bridge Bank agreed to provide to CXR Larus up to \$800,000 of advance on trade accounts receivable at an advance rate of 80% with interest at the Prime Rate (currently 3.25%) plus 3.25%. To secure Bridge Bank's obligations, Bridge Bank was granted continuing security interest in certain collateral of CXR Larus. The Company has guaranteed the obligations of CXR Larus under the Business Financing Agreement pursuant to a Guaranty, dated as of October 22, 2010, effective November 15, 2010. As of March 31, 2013, CXR Larus had borrowings of \$70,000 under the Business Financing Agreement.

## **EMRISE CORPORATION**

### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

#### **Promissory Notes Payable**

The promissory notes are subordinated contingent promissory notes, which were originally issued to the former owners of ACC in May 2008 and were originally scheduled to mature on August 31, 2013. The notes are subordinated to the term loan from Lloyds TSB described below. Since the notes were issued there have been various amendments, most recently, effective November 1, 2012 (the “Amended Subordinated Contingent Notes”). The Amended Subordinated Contingent Notes bear interest at the prime rate as reported in The Wall Street Journal (currently 3.25%) plus 4% (previously prime rate plus 1%) and mature on December 15, 2014 (the “Maturity Date”) (previously August 31, 2013). Interest is payable quarterly through to the Maturity Date. Principal payments commenced on January 15, 2013 in the amount of \$0.3 million. Further payments of principal amounting to \$0.3 million are payable on each of September 15, 2013, March 15, 2014, and September 15, 2014. The outstanding principal balance of \$1.7 million is due at the Maturity Date. As of March 31, 2013, the outstanding principal balance under the Amended Subordinated Contingent Notes was \$2,577,000.

#### **Lloyds TSB Term Loan**

On August 2, 2011, EMRISE Electronics Limited (“EEL”), a wholly-owned subsidiary of the Company, entered into a term loan with Lloyds TSB Bank plc (“Lloyds Bank”) in the amount of £750,000 (“Lloyds Term Loan”). As a condition to issuing the Lloyds Term Loan, each of the two operating subsidiaries of EEL, Pascall and XCEL, were required to provide £125,000 to an escrow account in each subsidiary’s name. The funds were to be held in escrow through to September 2012 at which time, Lloyds Bank could review and either renew or release the funds. Since the timing of release of the restricted funds was uncertain and Lloyds Bank was allowed to renew the restriction annually for the term of the loan, the total amount of £250,000 (\$405,000 based on the exchange rate at December 31, 2012) was included in the accompanying balance sheet as a non-current asset at December 31, 2012. Since that date the sum has been released and was utilized as partial payment for the purchase of a freehold property housing the production and administrative facility of Pascall. The Lloyds Term Loan bears interest at a fixed rate of the aggregate of 4.75% per annum and the rate quoted by the Lloyds Bank Wholesale Markets division at or about the time of borrowing. Principal and interest are payable monthly over 60 months commencing one month after the date of borrowing. The Lloyds Term Loan is subject to a financial covenant requiring a minimum net worth at EEL from and after December 31, 2012 of not less than £4,400,000 and shall increase annually by not less than £200,000. The Lloyds Term Loan was funded on August 30, 2011. As of March 31, 2013, £538,000 (or \$819,000 based on the exchange rate at March 31, 2013) was outstanding under the Lloyds Term Loan.

#### **Lloyds Bank Mortgage**

On March 4, 2013, the Company entered into a mortgage with Lloyds Bank for the sum of £1.4 million (approximately \$2.1 million at the rate of exchange on March 31, 2013) to purchase the property occupied by Pascall. This mortgage is repayable over 20 years. Interest is fixed at an annual rate of 4.8% for 15 years. Thereafter the interest reverts to a rate linked to the London Inter-bank lending rate. The loan is secured by a fixed lien over the property and any fixed plant and machinery within the building. The loan agreement contains financial covenants requiring the loan to value ratio to be a minimum of 80%, the net worth of EEL, the immediate parent company of Pascall, to be at least £4,776,000 and annual retained profits not to fall below £300,000 (approximately \$7,260,000 and \$456,000 using the exchange rate at March 31, 2013). At December 31, 2012, the net worth of EEL, as defined by the loan agreement, was £5,100,000 and the profit for the year ended December 31, 2012 was £1 million. As of March 31, 2013, the loan balance outstanding was \$2,124,000 and the property was valued at \$2.7 million.

## **PEM**

The PEM Credit Agreement was originally advanced in November 2007 for an aggregate amount of \$26 million. Since that date, the Company has repaid portions of the loan in accordance with the loan terms. On February 8, 2012, the lender accepted a Second Amended and Restated Term Loan A Note, which was amended for terms both of principal repayment and maturity date (the “Note”). The Note was payable on a monthly interest only basis through to February 28, 2013. The Note was payable at a rate of 15.5% per annum until paid in full, plus any applicable default rate or late fees. The Note required a one-time principal payment to the lender on or before February 29, 2012 in the amount of \$500,000. This was paid on schedule. In addition, if the Company paid certain amounts of principal before specific dates, the remainder of the principal amount would be deemed to be paid in full. Under this provision, the Company paid \$225,000 prior to June 30, 2012 and as a result, the accrued balance outstanding (including an accrual for the debt premium) was extinguished.

## **Capital Leases**

The Company has capital leases relating to capital equipment. The leases generally contain purchase options and expire at various dates through December 31, 2016. Capitalized lease obligations are calculated using interest rates appropriate at the inception of the lease and range from 6% to 18%. Leases are amortized over the lease term using the effective interest method.

**EMRISE CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 13 — FAIR VALUE MEASUREMENTS**

FASB guidance for fair value measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants and also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The fair value hierarchy distinguishes between three levels of inputs that may be utilized when measuring fair value as follows:

Level 1 — Inputs are unadjusted quoted prices in active markets for identical assets or liabilities available at the measurement date.

Level 2 — Inputs are unadjusted quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs derived from or corroborated by observable market data.

Level 3 — Inputs that are unobservable inputs which reflect the reporting entity's own assumptions on what assumptions the market participants would use in pricing the asset or liability based on the best available information.

Cash, accounts receivable, accounts payable and accrued expenses reflected in the unaudited condensed consolidated balance sheets are a reasonable estimate of their fair value due to the short term nature of these instruments. The carrying value of the Company's borrowings is a reasonable estimate of its fair value as borrowings under the Company's financing arrangements have variable rates that reflect currently available terms and conditions for similar debt. As of March 31, 2013, the Company did not have any financial assets and liabilities measured at fair value on a recurring basis that would be subject to the disclosure provisions of FASB guidance noted above.

**NOTE 14 — CASUALTY LOSS**

The Company's French subsidiary, CXR AJ, sustained significant damage to a portion of its premises as a result of a fire in 2010. Building, inventory and equipment were impaired or totally destroyed. The Company's insurers met immediate costs to replace or repair assets and income of \$300,000 for actual and anticipated proceeds in excess of the net book value of assets lost was recognized in 2011.

At December 31, 2011, a receivable of €194,000 (\$251,000) was recorded in relation to further amounts expected to be received from the insurance company. This amount was included in Prepaid and other current assets of the Condensed Consolidated Balance Sheet at December 31, 2011. In the three month period to March 31, 2012, the Company received a sum of €90,000 (approximately \$121,000) and further settlements totaling €86,000 (approximately \$114,000) were paid by the insurance company directly to suppliers. Subsequent to this, in the first quarter of 2012, the Company received €250,000 (approximately \$331,000) and an additional amount of €139,000 (approximately \$175,000) in respect of business interruption in July 2012. The amount recognized in the Statement of Operations for the year ended December 31, 2012 was \$473,000. No sums were received during the three months ended March 31, 2013 nor were any sums receivable at March 31, 2013.

## EMRISE CORPORATION

### ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### Cautionary Statement

This quarterly report on Form 10-Q and other reports filed by EMRISE Corporation ("we," "us," "our," or the "Company") from time to time with the United States Securities and Exchange Commission (the "SEC") contain or may contain forward-looking statements (collectively the "Filings") and information that are based upon beliefs of, and information currently available to, our management as well as estimates and assumptions made by our management and made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934. Readers are cautioned not to place undue reliance on these forward-looking statements, which are only predictions and speak only as of the date hereof. When used in the Filings, the words "anticipate," "believe," "estimate," "expect," "future," "intend," "plan," or the negative of these terms and similar expressions as they relate to us or our management identify forward-looking statements. Such statements reflect our current view with respect to future events and are subject to risks, uncertainties, assumptions, and other factors, including those set forth in the Risk Factors in Part II Item 1A, and elsewhere in our annual report on Form 10-K for the year ended December 31, 2012. Should one or more of these risks or uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may differ significantly from those anticipated, believed, estimated, expected, intended, or planned.

The Company does not undertake to update, revise or correct any forward-looking statements. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. Except as required by applicable law, including the securities laws of the United States, we do not intend to update any of the forward-looking statements to conform these statements to actual results.

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. Our financial statements would be affected to the extent there are material differences between these estimates and actual results. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. The following discussion should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this report.

Any of the factors described above or in the “Risk Factors” sections contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012, as amended, could cause the financial results, including the Company’s net income or loss or growth in net income or loss to differ materially from prior results, which in turn could, among other things, cause the price of its common stock to fluctuate substantially.

## **Plan of Operation**

The Company has a three-year strategic plan which is reviewed and updated annually. This plan details the opportunities for and the strengths of, our two business segments and addresses how management intends to exploit these. Detailed financial budgets covering income statements, cash flows and capital expenditure plans supported by existing backlog data and sales forecasts, which are linked to incentive plans, are produced annually by each subsidiary. The consolidated projections are critically reviewed, discussed and approved by the Company’s management team and by the Company’s board of directors (the “Board”).

The Company’s 2013 plan includes a continuation of the growth in the electronic devices segment and deeper penetration of U.S., European and North African markets for the sale of the Company’s communications equipment products. The Company’s management team believes that this growth can be achieved without a material increase in manpower or a significant increase in working capital. The Company is a small and flexible player in a rapidly changing world market. The Company’s technical expertise coupled with this flexibility means the Company is well placed to respond to new opportunities and management anticipates that this will be an important aspect in exploiting its niche markets in the remainder of 2013.

## **EMRISE CORPORATION**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

#### **Results of Operations**

##### *Overview*

A small increase in sales in both the electronic devices and the communications segments compared with the same three-month period in 2012, translated into an 8% increase in gross profit. Despite this improvement, the Company suffered a loss before tax for the first quarter of 2013, of \$362,000. The quarter to March 31, when we bear the largest proportion of our professional fees in connection with the issuance of our annual filings, is traditionally the weakest quarter of the Company's year so the loss was not unexpected. The result was after charging final redundancy costs in our U.S. communications business of \$34,000 and suffering a delay on a large delivery shipment in France which had it not been held up at French Customs would have generated additional profits of approximately \$50,000. The continuation of the strong performance in our UK based businesses resulted in a tax charge of \$166,000.

Overall net sales from continuing operations increased by \$152,000 or 2.0% in the first quarter of 2013 compared to the first quarter of 2012. 2012 was a strong year for our electronic devices segment so we were pleased to continue this growth with a 1.7% increase in the core commercial aerospace and military products from our electronic devices business units. This was supplemented by the improving sales levels at our French communications business (up 3.7%) and stabilized sales at our U.S. communications equipment business unit. The unique product specifications of our customers, which is a feature of most of the Company's electronic devices products, frequently results in long lead times between orders and requested delivery dates, making revenues and gross profit difficult to forecast and comparability of results between periods subject to fluctuations influenced by specific orders. Shipments of products can be accelerated or delayed due to many reasons including, but not limited to, exceeding or not meeting customer contract requirements, a change in customer timing or specifications, technology related issues, delays in acquiring component parts, and other production related issues. For a significant portion of our business, customers issue binding purchase orders or enter into binding agreements for the products to be produced and shipped over time in the future. Our "backlog" represents these orders and provides a partial view into potential shipments and revenues.

The steady escalation of demand for the electronic devices products produced by the Company's UK subsidiaries is encouraging and the order-book maintained by these companies shows no sign of diminishing, however, we continue to experience some uncertainty from our customers over when they will call-down these orders. The previously reported decline in infrastructure spending in the United States by telecommunications companies and the U.S. government specifically for the Company's synchronization and timing products and legacy network access products

continues and this is hindering progress to increase sales at our U.S. communications business. International orders, including the strengthening return of orders from North Africa for the Company's French network access products have continued to provide a solid backlog of orders which remains substantially higher than in previous years and the local sales teams continue to work to counter the trend in the synchronization and timing products with a ramp up of the Company's network access products in the United States although this remains slower than management planned.

Overall gross profit as a percentage of sales ("Gross Margin") in the first quarter of 2013 showed an increase, over the first quarter of 2012 at 29.6% compared with 28%. This reflects the strong performance from the electronic devices segment of the business but also an improvement in the Gross Margin at our U.S. based business where cost cutting measures have improved performance.

### *Comparison of the Three Months Ended March 31, 2013 and 2012*

#### **Net Sales**

| (in thousands)                               | <b>Three Months Ended</b> |                       | <b>Variance Favorable</b> |               |                |
|----------------------------------------------|---------------------------|-----------------------|---------------------------|---------------|----------------|
|                                              | <b>March 31, 2013</b>     | <b>March 31, 2012</b> | <b>(Unfavorable)</b>      | <b>Dollar</b> | <b>Percent</b> |
| Electronic devices                           | \$5,509                   | \$5,416               | \$ 93                     | 1.7           | %              |
| as % of net sales from continuing operations | 71.6 %                    | 71.8 %                |                           |               |                |
| Communications equipment                     | \$2,182                   | \$2,123               | \$ 59                     | 2.8           | %              |
| as % of net sales from continuing operations | 28.4 %                    | 28.2 %                |                           |               |                |
| Total net sales from continuing operations   | \$7,691                   | \$7,539               | \$ 152                    | 2.0           | %              |

#### *Electronic Devices Segment*

There was a small increase in net sales for our electronic devices segment of 1.7% during the first quarter of 2013 as compared to the first quarter of 2012. This comes after a 17.2% increase in the first quarter of 2012 over the 2011 sales. Sales of commercial aerospace In-Flight Entertainment and Connectivity products and military products continue in line with the Company's plans and we continue to see a strong order book in these areas, however, the timing of customer shipments can change due to the customized nature of our electronic devices business so there is no guarantee that this order book will translate into sales in the remainder of 2013. In addition, the negative or positive translation impact of exchange rates between the U.S. dollar and the British pound sterling remains an uncertainty over which the Company has no control.

**EMRISE CORPORATION****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
OF OPERATIONS***Communications Equipment Segment*

During 2012 we reported a decline in demand for our traditional communication products in our communications equipment company in the United States. The demand remains weak for these devices, but we have restructured the company to work at these lower sales levels, providing the platform to rebuild the business with the newer generation IP based, European network access products.

**Gross Profit**

|                                               | Three Months Ended |         | Variance                |         |   |
|-----------------------------------------------|--------------------|---------|-------------------------|---------|---|
|                                               | March 31,          |         | Favorable (Unfavorable) |         |   |
| (in thousands)                                | 2013               | 2012    | Dollar                  | Percent |   |
| Electronic devices                            | \$1,621            | \$1,462 | \$ 159                  | 10.9    | % |
| as % of net sales from continuing operations  | 29.4 %             | 27.0 %  |                         |         |   |
| Communications equipment                      | \$656              | \$647   | \$ 9                    | 1.4     | % |
| as % of net sales from continuing operations  | 30.1 %             | 30.5 %  |                         |         |   |
| Total gross profit from continuing operations | \$2,277            | \$2,109 | \$ 168                  | 8.0     | % |
| Total gross margin from continuing operations | 29.6 %             | 28.0 %  |                         |         |   |

*Electronic Devices Segment*

A change in the product mix with a greater volume of higher margin military sales was the main driver of the improved gross margin in the period.

*Communications Equipment Segment*

The very small decrease in gross margin for our communications equipment segment was primarily due to a change in product mix reflecting a greater proportion of resale products.

## Operating Expenses

| (in thousands)                                      | Three Months Ended March 31, |         | Variance Favorable (Unfavorable) |         |   |
|-----------------------------------------------------|------------------------------|---------|----------------------------------|---------|---|
|                                                     | 2013                         | 2012    | Dollar                           | Percent |   |
| Selling, general and administrative                 | \$2,350                      | \$2,363 | \$ 13                            | 0.6     | % |
| as % of net sales from continuing operations        | 30.6 %                       | 31.3 %  |                                  |         |   |
| Engineering and product development                 | \$295                        | \$339   | 44                               | 13.0    | % |
| as % of net sales from continuing operations        | 3.8 %                        | 4.5 %   |                                  |         |   |
| Total operating expenses from continuing operations | \$2,645                      | \$2,702 | 57                               | 2.1     | % |

### *Selling, general and administrative expenses*

Selling, general and administrative (“SG&A”) expenses for the first quarter of 2013 remained largely unchanged from prior year in line with our expectations.

### *Engineering and product development*

The costs expensed to engineering and product development are a function of the split between costs which relate to customer specific engineering projects which can be charged as a cost of the production project and those costs which are not attributable to a specific customer project. Engineering and product development costs that could not be recharged to customers, as a percentage of net sales, showed a small decrease at 3.8% in the first quarter of 2013 compared to 4.5% in the first quarter of 2012.

## **EMRISE CORPORATION**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

#### **Interest expense**

Interest expense was \$118,000 for the first quarter of 2013 compared to \$91,000 for the first quarter of 2012. The 2013 cost includes one month of expense for the mortgage taken out for the purchase of the building in the United Kingdom. The interest expense associated with the purchase of the property at Pascall is approximately \$8,500 per month (based on the average exchange rate in the month of March 2013). This cost will be offset by lower property rental charges reducing future general and administrative costs.

#### **Other income and expense**

We recorded other income of \$103,000 in the first quarter of 2013 compared to an expense charge of \$78,000 in the first quarter of 2012. The fluctuation stems from the short-term exchange rate gains and losses associated with the volatility of the U.S. dollar to the British pound sterling and Euro on the current portion of certain assets and liabilities. In the first quarter of 2013, the U.S. dollar appreciated 6% against British pound sterling compared with 2% depreciation in the same quarter in 2012. As a large proportion of the Company's sales and purchases are denominated in sterling this volatility can have a marked impact on the income in any quarter and there is no guarantee that we will continue to benefit from similar movements in subsequent quarters.

#### **Loss from continuing operations**

The loss from continuing operations was \$528,000 in the first quarter of 2013 compared to a loss from continuing operations of \$862,000 in the first quarter of 2012. Traditionally the Company has suffered losses in the first quarter of its fiscal year, as explained above, and this loss was anticipated. The reduction in the loss in the first quarter of 2013 compared to the first quarter of 2012 principally results from a further improvement in the gross profit at our electronic devices segment.

#### **Net loss**

After recording a tax charge of \$166,000 we reported a net loss of \$528,000 in the first quarter of 2013 compared to a net loss of \$871,000 in the first quarter of 2012.

## **Liquidity and Capital Resources**

In making an assessment of our liquidity, we believe that the items in our financial statements that are most relevant to our ongoing operations are working capital, cash generated from operating activities and cash available from financing activities. We have a variety of financing arrangements to support working capital.

### *Working Capital*

The Company funds its daily cash flow requirements through funds provided by operations and through borrowings under various financing arrangements. After recognizing the \$2.1 million liability relating to the mortgage advance in the first quarter of 2013 and the cash payment of \$0.5 million, to pay for the premises purchased for our Pascall subsidiary, working capital was \$5.8 million as of March 31, 2013 compared with \$7.5 million as of December 31, 2012. The Company has counteracted the impact of the losses from operations by managing its working capital tightly, translating inventory into sales and collecting receivables promptly. Strong cash collection from customers has funded increased purchases to meet the increasing production demanded by the Company's order book. As of March 31, 2013, the Company had cash and cash equivalents of \$1.1 million as compared with \$1.5 million at December 31, 2012.

As of March 31, 2013, approximately \$0.9 million, or 87%, of the total \$1.1 million of cash and cash equivalents were held by our foreign subsidiaries. The majority of our foreign cash balances are associated with earnings that we have represented to our bankers are permanently reinvested and which we plan to use to support our continued growth plans outside of the United States through funding of capital expenditures, engineering, operating expenses or other similar cash needs of our foreign operations. From time to time, we repatriate cash from our foreign subsidiaries to the United States for normal corporate operating needs through inter-company dividends and service and brand charges, but only from those earnings we have not asserted to be permanently reinvested or whose earnings qualify as previously taxed income as defined by the United States Internal Revenue Code. However, the foreign subsidiaries previously issued guarantees to lenders on certain financing arrangements and, as a result, under the United States Internal Revenue Code, have been deemed to have distributed these earnings to fund U.S. operations.

We expect to generate more cash from operations through the remainder of 2013, as the Company translates its strong order book into higher levels of shipments which in turn contributes to higher levels of collections on accounts receivable in subsequent periods. We control our working capital tightly but our ability to generate cash from operations has been and will continue to be, impacted by the requirement to acquire inventory to satisfy increasing shipments associated with the substantial order book, the timing of these shipments and the timing related to the

collection of customer receivables accounts associated with these shipments. We continually monitor our need to invest in engineering and personnel to support such growth but we do not currently foresee any need to increase our headcount. There are no significant capital expenditure plans that will require funding from our current working capital. The Company's cash flow projections indicate that there will be sufficient cash to service the interest on existing debt and also meet the loan repayments scheduled over the twelve months ending March 31, 2014, which will include the repayment of two additional tranches of the promissory notes of \$300,000 each to the former shareholders of ACC.

## **EMRISE CORPORATION**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

#### *Backlog*

Our future book of shippable orders ("Backlog") was \$24.5 million as of March 31, 2013, compared to \$22.6 million as of December 31, 2012. The amount of Backlog orders represents revenue that we anticipate recognizing in the future, as evidenced by purchase orders and other purchase commitments received from customers, but on which work has not yet been initiated or is currently in progress. As of March 31, 2013, approximately 89% of our Backlog related to our electronic devices business, which have variable lead times for our manufacturing processes due to the custom nature of the products. Approximately 11% of the Backlog is related to our communications equipment business, which tends to deliver standard or modified standard products from stock as orders are received. We believe that a significant portion of our current Backlog will be shipped within the next 12 months. However, there can be no assurance that we will be successful in fulfilling such orders and commitments in a timely manner or that we will ultimately recognize as revenue the amounts reflected as Backlog.

#### *Debt and Financing Arrangements*

As of March 31, 2013, we had total debt obligations of \$6.5 million. A summary of this debt is shown in Note 12 to the Condensed Consolidated Financial Statements in this Form 10-Q.

Total debt includes \$800,000 relating to subsidiary financing arrangements linked to accounts receivable, capital lease obligations of \$190,000, a term loan with Lloyds Bank of \$800,000 and promissory notes payable in connection with the acquisition by the Company of ACC to the former shareholders of ACC (the "Former Shareholders") of approximately \$2.6 million (maturing December 15, 2014). In addition, in this quarter, the Company entered into a mortgage of approximately \$2.1 million from Lloyds Bank. The current portion of the Company's loans and obligations (including lines of credit) totaled \$1.8 million at March 31, 2013.

#### *Financing Arrangements*

The Company has lines of credit for its operating subsidiaries based on the level of accounts receivable.

The two subsidiaries in England, Pascall and XCEL, have a Receivables Finance Agreement with Lloyds TSB Commercial Finance (“Lloyds”) which provides a credit facility of up to £2.75 million (\$4.2 million based on the exchange rate on March 31, 2013). As of March 31, 2013, outstanding borrowings under the Receivables Finance Agreements were \$517,000.

The Company’s French subsidiary, CXR AJ, has a Factoring Agreement with FACTOCIC S.A., with a principal amount of €1.35 million (\$1.7 million based on the exchange rate on March 31, 2013). As of March 31, 2013, CXR AJ had outstanding borrowings under the CIC Agreement of \$216,000 (based on the exchange rate on March 31, 2013).

CXR Larus, in the U.S., is funded by a financing agreement with Bridge Bank which grants CXR Larus up to \$800,000 of advance on trade accounts receivable at an advance rate of 80%. As of March 31, 2012, CXR Larus had borrowings under the Business Financing Agreement of \$70,000.

#### Promissory Notes Payable

The Former Shareholders’ subordinated secured contingent promissory notes, which the Company issued in May 2008 in connection with the acquisition of the ACC business were subsequently amended, most recently in November 2012. The Former Shareholders are individuals who owned ACC stock in 2008. The Amended Subordinated Contingent Notes bear interest at the prime rate as reported in The Wall Street Journal plus 4% and mature on December 15, 2014 (the “Maturity Date”) . Interest is payable quarterly. The first principal payment of \$300,000 was made in January 2013 and further payments of principal of \$300,000 each are due in September 2013, March 2014 and September 2014 with a final balance of \$1.7 million due at the Maturity Date. As of March 31, 2013, the Company had Amended Subordinated Contingent Notes with a principal balance of approximately \$2.6 million outstanding.

#### Term Loan

Emrise Electronics Limited (“EEL”), a wholly owned subsidiary of the Company, has a term loan with Lloyds Bank in the amount of £750,000. The loan bears interest at a fixed rate of 4.75% above Lloyds Bank Wholesale Markets rate per annum. Principal and interest are payable monthly over 60 months. The loan is subject to a financial covenant requiring a minimum net worth at EEL of not less than £4,400,000 (at December 31, 2012) and increases annually by not less than £200,000. As of March 31, 2013, £540,000 (or \$0.8 million based on the exchange rate at September 30, 2012) was outstanding under the Lloyds Term Loan.

## **EMRISE CORPORATION**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

#### *Mortgage*

Pascall, a wholly owned subsidiary of the Company, entered into a mortgage agreement, with Lloyds Bank, in February 2013. The mortgage was used to purchase the property occupied by Pascall in the UK. The mortgage which is repayable over a period of 20 years carries interest at 4.8% for the first 15 years and thereafter reverts to a rate linked to London inter-bank interest rates. The loan is secured by a fixed lien over the property and any fixed plant and machinery within the building. The loan agreement contains financial covenants requiring the loan to value ratio to be a minimum of 80%, the net worth of EEL, the immediate parent company of Pascall, to be at least £4,776,000 and annual retained profits of EEL not to fall below £300,000 (approximately \$7,260,000 and \$456,000 using the exchange rate at March 31, 2013). At December 31, 2012, the net worth of EEL, as defined by the loan agreement, was £5,100,000 and the profit for the year ended December 31, 2012 was £1 million. As at March 31, 2013, the loan balance outstanding was \$2,124,000 and the property was valued at \$2.7 million.

#### *Liquidity*

The Company's liquidity is closely monitored by management. The most relevant factors are working capital, cash generated from operating activities and cash available from financing activities. The Company has a variety of financing arrangements to support working capital and other short and long-term debt and uses cash flow forecasting linked to production forecasts and existing and projected credit and bank facilities, to ensure there are sufficient resources to fulfill short term needs and strategic plans. The Company has a long term bank facility in the UK with Lloyds Bank which extends to August 2016, a 20 year mortgage of \$2.1 million also with Lloyds Bank, and has issued promissory notes, totaling \$2.6 million, which are not due for full repayment until December 2014. The UK term loan from Lloyds Bank has a covenant that links to the net worth of the Company.

Short-term credit facilities are heavily dependent upon the sales and underlying profitability of the Company's subsidiaries. Credit facilities for the operating subsidiaries are a function of accounts receivable. There are no other major capital expenditure plans which will absorb working capital and management considers that the current level of working capital is adequate for the Company's current requirements. The majority of the Company's cash is held by its foreign subsidiaries. There are limitations on the amounts that may be repatriated for use in paying corporate expenses and paying corporate debt. The overseas companies pay management charges to the parent Company for management services and brand name use and also pay dividends if and when appropriate.

As a result of the combination of forecasted cash flows from operations and existing financing arrangements, the Company believes it has sufficient funding to support its working capital requirements during the next 12 months. The Company has a substantial backlog as of March 31, 2013, and the Company continues to experience good booking levels to support future shipments. In order to support future expected growth, the Company will reinvest a substantial amount of cash from operations, back into the business for inventory purchases, engineering and product development. The Company recognizes the need to closely manage cash from operations to meet the operational needs of the business and satisfy near-term debt service obligations. The Company's ability to support its business plan is dependent upon its ability to achieve profitable operations, manage costs and satisfy long-term debt service obligations, of which promissory note principal payments of \$600,000 are payable over the next 12 months. Taking these factors into consideration, management believes the Company will be able to satisfy its long-term debt service obligations for the next twelve months from the date of issuance of these financial statements, and meet its short term obligations and commitments.

### **Effects of Inflation**

The impact of inflation and changing prices has not been significant on the financial condition or results of operations of either the Company or our operating subsidiaries for the past two years.

### **Critical Accounting Policies**

The discussion and analysis of the Company's financial condition and results of operations is based upon the consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of net sales and expenses for each period. The following represents a summary of the critical accounting policies, defined as those policies that management believes are the most important to the portrayal of the financial condition and results of operations and that require management's most subjective or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

## **EMRISE CORPORATION**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

#### ***Revenue Recognition***

Revenues are derived from sales of electronic devices and communications equipment products and services and extended warranty contracts. Sales are based upon written agreements or purchase orders that identify the type and quantity of the item and/or services being purchased and the purchase price. Revenues are recognized when shipment of products has occurred or services have been rendered, no significant obligations remain on the part of the Company, and collection is reasonably assured based on the Company's knowledge of the customer and credit and collections practices and policies.

Revenues from domestic sales are recognized at the point of shipment of those products. An estimate of warranty cost is recorded at the time the revenue is recognized. Product returns are infrequent and require prior authorization because sales are final and the Company quality tests products prior to shipment to ensure the products meet the specifications of the binding purchase orders under which those products are shipped. Normally, when a customer requests and receives authorization to return a product, the request is accompanied by a purchase order for a repair or for a replacement product.

Revenue recognition for products and services provided by the Company's subsidiaries in England depends upon the type of contract involved. Engineering/design services contracts generally entail design and production of a prototype over a term of up to several years, with revenue deferred until recognized over the term of the contract under either a percentage of completion basis. Production contracts provide for a specific quantity of products to be produced over a specific period of time. Customers issue binding purchase orders or enter into binding agreements for the products to be produced. The Company recognizes revenues on these orders as the products are shipped. Returns are infrequent and permitted only with prior authorization because these products are custom made to order based on binding purchase orders and are quality tested prior to shipment. An estimate of warranty cost is recorded at the time revenue is recognized. The Company offers extended warranty contracts for an additional cost to its customers, which are recognized ratably over the term of the extended warranty contract.

Revenues for products sold by the Company's subsidiary in France are recognized at the point of shipment. Customer discounts are included in the product price list provided to the customer. Returns are infrequent and permitted only with prior authorization because these products are shipped based on binding purchase orders and are quality tested prior to shipment. An estimate of warranty cost is recorded at the time revenue is recognized.

Revenues from services such as repairs and modifications are recognized when the service is completed and invoiced. For repairs that involve shipment of a repaired product, the Company recognizes repair revenues when the product is shipped back to the customer. Service revenues contribute less than 3% of total revenue and, therefore, are not considered to be material to the overall financial results.

### ***Product Warranty Liabilities***

Generally, the Company's products carry a standard one-year, limited parts and labor warranty. In certain circumstances, a two-year limited parts and labor warranty is offered. Extended warranties beyond two years are sometimes offered to customers for an additional cost. Products returned under warranty typically are tested and repaired or replaced at the Company's option. Historically, the Company has not experienced significant warranty costs or returns.

A liability is recorded for estimated costs that the Company expects to incur under the basic limited warranties when product revenue is recognized. Factors affecting the warranty liability include the number of units sold, the types of products involved, historical and anticipated rates of claim and historical and anticipated costs per claim. The Company regularly assesses the adequacy of the warranty liability accrual based on changes in these factors.

### ***Inventory Valuation***

Electronic devices are generally built to specific order whereas communications equipment is more generally built to forecast. Consequently, the Company produces finished goods in the communications equipment business to enable prompt service to customers. The Company's products consist of numerous electronic and other materials, which necessitate detailed inventory management. Inventory is valued at the lower of the cost to purchase or manufacture the inventory (first-in, first-out) and the current estimated market value of the inventory (net realizable value). The Company adopts a cyclical approach to counting inventories using an ABC inventory methodology, which groups inventory items into prioritized cycle counting categories, and physical inventory inspections are carried out at least once a year. Inventory quantities on hand are regularly reviewed and a provision for excess and obsolete inventory based primarily on the estimated forecast of product demand and production requirements for the next 12 to 24 months are recorded. Additionally, to determine inventory write-down provisions, product line inventory levels and individual items are reviewed as necessary and periodically assumptions about the forecast demand and market conditions are revised. Any inventory that is determined to be either obsolete or in excess of future demand, is specifically reserved for, and subsequently written-off.

The electronic devices and communications equipment industries are characterized by rapid technological change, frequent new product development, and rapid product obsolescence that could result in an increase in the amount of obsolete inventory quantities on hand. Also, estimates of future product demand may prove to be inaccurate, in which

case the Company may have understated or overstated the provision required for excess and obsolete inventory. Although every effort is made to ensure the accuracy of forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of the inventory and the reported operating results.

**EMRISE CORPORATION****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
OF OPERATIONS*****Foreign Currency Translation and Exchange***

Foreign subsidiaries account for approximately 95% of the Company's net revenues, 96% of our total assets and 75% of the Company's total liabilities as of and for the three months ended March 31, 2013. In preparing the consolidated financial statements, the financial statements of the foreign subsidiaries are translated from the functional currencies in which their accounting records are maintained, into U.S. dollars, the Company's reporting currency. The assets and liabilities of the foreign entities have been translated to U.S. dollars at the current rate of exchange as of the balance sheet date and an average exchange rate for the period is used to translate the statement of operations. Translation adjustments are included in other comprehensive income/(loss). The magnitude of these gains or losses depends upon movements in the exchange rates of the foreign currencies in which the Company transacts business as compared to the value of the U.S. dollar. These currencies include the euro and the British pound sterling. Cumulative translation losses of \$2.4 million were included as part of accumulated other comprehensive loss within the balance sheet at March 31, 2013. During the three months ended March 31, 2013, the Company included translation losses of \$0.7 million under accumulated other comprehensive income. Any future translation gains or losses could be significantly higher or lower than those we recorded for these periods.

The relevant rates at March 31, 2013 and 2012 and the average rate for the three months ended March 31, 2013 and 2012 were:

|                                    | <b>US \$<br/>equivalent<br/>2013 2012</b> |      |
|------------------------------------|-------------------------------------------|------|
| Period end rate                    |                                           |      |
| £ Sterling                         | 1.52                                      | 1.60 |
| Euro                               | 1.28                                      | 1.33 |
| Average for the three month period |                                           |      |
| £ Sterling                         | 1.55                                      | 1.57 |
| Euro                               | 1.32                                      | 1.31 |

If the Company disposes of any subsidiaries, any cumulative translation gains or losses would be realized into the statement of operations.

***Long-Lived Assets and Amortizing Intangible Assets***

The Company reviews the carrying amount of its long-lived assets and other amortizing intangible assets, for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Amortizing intangible assets are stated at cost, less accumulated amortization, and are amortized on the straight-line method over their estimated useful lives ranging from two to twenty years. The Company periodically reviews the original estimated useful lives of long-lived assets and makes adjustments when appropriate.

***Goodwill and Indefinite Lived Intangible Assets***

The Company evaluates goodwill and indefinite lived intangibles in accordance with Financial Accounting Standards Board's Accounting Standard Codification ("ASC") 350, Intangibles-Goodwill and Other. The Company annually tests for impairment of goodwill and indefinite lived intangibles and tests more frequently if an event occurs or circumstances change that suggest that there is an indicator of impairment. The Company's test for goodwill impairment is based on the two step approach whereby in step one if the carrying value of the reporting unit exceeds the fair value of the reporting unit, an impairment is indicated and the amount of impairment is then calculated by the amount the carrying value of the goodwill exceeds the implied fair value of the goodwill. The Company's reporting units have been identified as electronic devices and communications equipment. The Company performed its annual required tests of impairment as of December 31, 2012 for goodwill in the electronic devices reporting unit. At March 31, 2013, the reported goodwill totalled \$4.9 million, all of which related to the electronic devices reporting unit.

At March 31, 2013, the reported indefinite-lived assets totalled \$0.36 million, all of which related to the electronic devices reporting unit.

## **EMRISE CORPORATION**

### **ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.**

The only derivative instruments held by the Company consist of forward purchases of U.S. Dollars but the amounts are not material. The Company does not engage in any other hedging activities.

### **ITEM 4. Controls and Procedures.**

#### **(a) Evaluation of Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports pursuant to the Securities Exchange Act of 1934, as amended, (the "Exchange Act") 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 management, including our Principal Executive Officer and our Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes 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 is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rules 13a-15 and 15d-15 of the Exchange Act, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, which were designed to provide reasonable assurance of achieving their objectives. This evaluation was carried out under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer. Based on this evaluation, our Principal Executive Officer and Principal Financial Officer have concluded that, as of March 31, 2013, our disclosure controls and procedures were effective at the reasonable assurance level to ensure (1) that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and (2) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

#### **(b) Changes in Internal Control over Financial Reporting**

There were no changes with respect to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting during the three months ended March 31, 2013.

## EMRISE CORPORATION

### PART II — OTHER INFORMATION

#### Item 1. Legal Proceedings.

We are currently not involved in any litigation that we believe could have a material adverse effect on our financial condition or results of operations. There is no action, suit, proceeding, inquiry or investigation before or by any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of the executive officers of our Company or any of our subsidiaries, threatened against or affecting our company, our common stock, any of our subsidiaries or of our companies or our subsidiaries' officers or directors in their capacities as such, in which an adverse decision could have a material adverse effect.

#### Item 1A. Risk Factors.

A description of the risks associated with our business, financial condition and results of operations is set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the SEC on March 29, 2013. These factors continue to be meaningful for your evaluation of the Company and we urge you to review and consider the risk factors presented in the Annual Report on Form 10-K. We believe there have been no changes that constitute material changes from these risk factors.

#### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

There were no unregistered sales of the Company's equity securities during the quarter ended March 31, 2013, that were not otherwise disclosed in a Current Report on Form 8-K.

#### Item 3. Defaults Upon Senior Securities.

There has been no default in payment of principal, interest, sinking or purchase fund installment, or any other material default, with respect to any indebtedness of the Company.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

There is no other information required to be disclosed under this item that has not previously been reported.

## EMRISE CORPORATION

### PART II — OTHER INFORMATION

Item 6 Exhibits.

#### Number Description

|      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1 | Contract for the Sale of freehold land, dated February 28, 2013, by and among Longford Estates Limited (in Administration), Matthew James Cowlshaw and Richard Michael Hawes, and Pascall Electronics Limited (as filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on March 27, 2013).                                                                                                                                                                                                                   |
| 10.2 | Mortgage deed, dated February 28, 2013, by and between Lloyds TSB Bank and Pascall Electronics Limited (as filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed on March 27, 2013).                                                                                                                                                                                                                                                                                                                          |
| 31.1 | Certification of Principal Executive Officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*                                                                                                                                                                                                                                                                                                                  |
| 31.2 | Certification of Principal Financial Officer required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*                                                                                                                                                                                                                                                                                                                  |
| 32.1 | Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*                                                                                                                                                                                                                                                                                                                                                                          |
| 32.2 | Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*                                                                                                                                                                                                                                                                                                                                                                          |
| 101  | The following financial information from EMRISE Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 formatted in XBRL: (i) Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012; (ii) Consolidated Statements of Operations and Statement of Comprehensive Income for the three months ended March 31, 2013 and 2012 (iii) Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012 and (iv) Notes to the Consolidated Financial Statements.* (1) |

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\*Filed herewith.

(1) Pursuant to Rule 406T of Regulation S-T, the interactive data files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as

amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

**EMRISE CORPORATION**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**EMRISE CORPORATION**

Dated: May 13, 2013 By: */s/ CARMINE T. OLIVA*  
Carmine T. Oliva,  
Chief Executive Officer (Principal Executive Officer)

Dated: May 13, 2013 By: */s/ TIMOTHY J. BLADES*  
Timothy J. Blades,  
Director of Finance  
(Principal Financial and Accounting Officer)

