Emrise CORP
Form 10-K
April 02, 2007

==

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

ANNUAL REPORT
PURSUANT TO SECTIONS 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)
|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended DECEMBER 31, 2006.

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
(Exact name of registrant as specified in its charter)

DELAWARE	77-0226211
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9485 HAVEN AVENUE, SUITE 100, RANCHO CUCAMONGA, CALIFORNIA	91730
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (909) 987-9220

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

Title of Each Class	Name of Each Exchange on Which Registered
COMMON STOCK, $0.0033 PAR VALUE	NYSE ARCA

Securities registered pursuant to Section 12(g) of the Act:
NONE
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes _____ No __X__

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes _____ No __X__

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of

1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes __X__ No _____

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

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

Large Accelerated Filer ___ Accelerated Filer ___ Non-Accelerated Filer _X_

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

The aggregate market value of the voting common equity held by nonaffiliates of the registrant, computed by reference to the $1.03 closing sale price of such stock on June 30, 2006, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $35,000,000. The registrant has no non-voting common equity.

The number of shares of the registrant's common stock, $0.0033 par value, outstanding as of March 16, 2006 was 38,136,750.

DOCUMENTS INCORPORATED BY REFERENCE: None.

TABLE OF CONTENTS

		Page
	PART I	
ITEM 1.	BUSINESS	1
ITEM 1A.	RISK FACTORS.	16
ITEM 1B.	UNRESOLVED STAFF COMMENTS	21
ITEM 2.	PROPERTIES	21
ITEM 3.	LEGAL PROCEEDINGS	22
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	22
	PART II	
ITEM 5.	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	22
ITEM 6.	SELECTED FINANCIAL DATA	24
ITEM 7.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	25

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.........46

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA........................47

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE..47

ITEM 9A. CONTROLS AND PROCEDURES..49

ITEM 9B. OTHER INFORMATION..49

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.............52

ITEM 11. EXECUTIVE COMPENSATION...55

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS...................................65

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE..67

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.............................69

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.........................70

INDEX TO FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE...............F-1

SIGNATURES...78

EXHIBITS ATTACHED TO THIS REPORT...79

CAUTIONARY STATEMENT

ALL STATEMENTS INCLUDED OR INCORPORATED BY REFERENCE IN THIS ANNUAL REPORT ON FORM 10-K, OTHER THAN STATEMENTS OR CHARACTERIZATIONS OF HISTORICAL FACT, ARE FORWARD-LOOKING STATEMENTS. EXAMPLES OF FORWARD-LOOKING STATEMENTS INCLUDE, BUT ARE NOT LIMITED TO, STATEMENTS CONCERNING PROJECTED NET SALES, COSTS AND EXPENSES AND GROSS MARGINS; OUR ACCOUNTING ESTIMATES, ASSUMPTIONS AND JUDGMENTS; OUR SUCCESS IN PENDING LITIGATION; THE DEMAND FOR OUR PRODUCTS; THE COMPETITIVE NATURE OF AND ANTICIPATED GROWTH IN OUR INDUSTRIES; OUR ABILITY TO IDENTIFY AND CONSUMMATE ACQUISITIONS AND INTEGRATE THEIR OPERATIONS SUCCESSFULLY; AND OUR PROSPECTIVE NEEDS FOR ADDITIONAL CAPITAL. THESE FORWARD-LOOKING STATEMENTS ARE BASED ON OUR CURRENT EXPECTATIONS, ESTIMATES, APPROXIMATIONS AND PROJECTIONS ABOUT OUR INDUSTRIES AND BUSINESS, MANAGEMENT'S BELIEFS, AND CERTAIN ASSUMPTIONS MADE BY US, ALL OF WHICH ARE SUBJECT TO CHANGE. FORWARD-LOOKING STATEMENTS CAN OFTEN BE IDENTIFIED BY WORDS SUCH AS "ANTICIPATES," "EXPECTS," "INTENDS," "PLANS," "PREDICTS," "BELIEVES," "SEEKS," "ESTIMATES," "MAY," "WILL," "SHOULD," "WOULD," "COULD," "POTENTIAL," "CONTINUE," "ONGOING," SIMILAR EXPRESSIONS, AND VARIATIONS OR NEGATIVES OF THESE WORDS. THESE STATEMENTS ARE NOT GUARANTEES OF FUTURE PERFORMANCE AND ARE SUBJECT TO RISKS, UNCERTAINTIES AND ASSUMPTIONS THAT ARE DIFFICULT TO PREDICT. THEREFORE, OUR ACTUAL RESULTS COULD DIFFER MATERIALLY

AND ADVERSELY FROM THOSE EXPRESSED IN ANY FORWARD-LOOKING STATEMENTS AS A RESULT OF VARIOUS FACTORS, SOME OF WHICH ARE LISTED UNDER "RISK FACTORS" IN ITEM 1A OF THIS REPORT. THESE FORWARD-LOOKING STATEMENTS SPEAK ONLY AS OF THE DATE OF THIS REPORT. WE UNDERTAKE NO OBLIGATION TO REVISE OR UPDATE PUBLICLY ANY FORWARD-LOOKING STATEMENT FOR ANY REASON, EXCEPT AS OTHERWISE REQUIRED BY LAW.

PART I

ITEM 1. BUSINESS.

OVERVIEW

We are a leading supplier of communication timing and synchronization systems, communication access devices, rotary and digital switches, electronic power supplies and radio frequency, or RF, and microwave devices. We sell our products to communications service providers, defense and aerospace contractors and industrial customers. We are a multinational company operating out of facilities located in the United States, United Kingdom, France and Japan. As of March 16, 2007, we had approximately 302 employees.

We are a Delaware corporation that was formed July 14, 1989. We have three wholly-owned operating subsidiaries, EMRISE Electronics Corporation, a New Jersey corporation that was formed in 1983 ("EMRISE Electronics"), CXR Larus Corporation, a Delaware corporation that was formed in 1984 ("CXR Larus"), and CXR-Anderson Jacobson, a French company that was formed in 1973 ("CXR-AJ").

In December 2004, CXR Larus changed its name from CXR Telcom Corporation when it succeeded by merger to the assets and liabilities of Larus Corporation, a San Jose, California-based manufacturer and seller of telecommunications products, and Vista Labs, Incorporated, a subsidiary of Larus Corporation that provided engineering services to Larus Corporation. As described in more detail elsewhere in this report, we acquired Larus Corporation and Vista Labs, Incorporated in July 2004.

In March 2005, EMRISE Electronics Ltd. ("EEL"), a United Kingdom-based subsidiary of EMRISE Electronics, acquired Pascall Electronic (Holdings) Limited ("PEHL") and its wholly-owned subsidiary, Pascall Electronics Limited ("Pascall"). Pascall is based in the United Kingdom and manufactures a range of custom proprietary power systems and RF devices.

In August 2005, EMRISE Electronics acquired all of the outstanding common stock of RO Associates Incorporated ("RO"), a manufacturer of standard power supplies located in Sunnyvale, California.

Through our operating subsidiaries, CXR Larus, CXR-AJ and EMRISE Electronics, and through the divisions and subsidiaries of those subsidiaries, we design, develop, manufacture, assemble, and market products and services in the following two material business segments:

- Electronic Devices
  - electronic power supplies
  - digital and rotary switches
  - RF and microwave devices

- Communications Equipment
  - network access and transmission products
  - communication timing and synchronization products
  - communications test instruments

Our sales are primarily in North America, Europe and Asia. Sales to customers in the electronic devices segment, primarily to defense and aerospace customers, defense contractors and industrial customers were approximately 70.5%, 62.6% and 51.1% of our total net sales during 2006, 2005 and 2004, respectively. Sales of communications equipment and related services, primarily to private customer premises and public carrier customers, were approximately 29.5%, 37.4% and 48.9% of our total net sales during 2006, 2005 and 2004, respectively.

Our objective in our electronic devices business is to become the supplier of choice for harsh environment, high reliability digital and rotary switches, custom and standard power supplies and RF and microwave products and subsystems. Our objective in our communications equipment business is to become a leader in quality, cost effective solutions to meet the requirements of communications equipment customers. We believe that we can achieve these objectives through customer-oriented product development, superior product solutions, and excellence in local market service and support.

INDUSTRY OVERVIEW

ELECTRONIC DEVICES

The electronic devices industry comprises three basic segments, which are active devices, passive devices and electromechanical devices. We compete in the active and electromechanical segments of this industry. These segments can be further segmented by industry into telecommunications, aerospace, defense, commercial, industrial and other environments, each of which places constraints that define performance and permitted use of differing grades of devices.

We are active only in the industry segments that are characterized by harsh environment, high reliability, low volume, high margin and long lead-times, namely the aerospace, defense and industrial segments. To support the myriad customers that rely on digital and rotary switches and electronic power supplies and RF and microwave devices, we believe that our electronic devices must offer high levels of reliability and in many cases must be tailored to the size, appearance, functionality and pricing needs of each particular customer.

The defense market, which is a predominant market for our electronic devices, makes use of sophisticated electronic assemblies in diverse applications that involve both original equipment and retrofit of existing equipment.

The Digitran division of EMRISE Electronics ("Digitran"), which EMRISE Electronics acquired from Becton Dickinson in 1985, has been manufacturing digital switches since the 1960s. XCEL Power Systems, Ltd. ("XPS"), a second-tier subsidiary of EMRISE Electronics, has been manufacturing electronic

power supplies since 1989. Pascall was formed in 1977.

COMMUNICATIONS EQUIPMENT

Over the past decade, telecommunications and data communications infrastructures have undergone significant growth and have become a critical part of the global business and economic infrastructure that has been driven by the following:

- a surge in demand for broadband access used to conduct e-commerce activities and transmit growing volumes of data, voice and video information;

- the adoption of Internet protocol, or IP, which is a protocol developed to enable the transmission of information as packets of data from a source to a recipient using dynamically changing routes, with the data being reassembled at the recipient's location into the original information format; and

- an apparent worldwide trend toward deregulation of the communications industry, which has enabled a large number of new communications service providers to enter the market.

This rapid growth has been succeeded by a period of consolidation. Private and corporate communications providers and other businesses that rely heavily on information technology continue to devote significant resources to the purchase of network access and transmission equipment, such as high-speed DSL and fiber optic modems, through which data and voice information may be transmitted.

To support the rapidly changing needs of telecommunications companies and information technology dependent businesses, we believe that network access and transmission products and communications test instruments must offer high levels of functional integration, automation and flexibility to operate across a variety of network protocols, technologies and architectures. Because the competition for subscribers for high-speed bandwidth access is intense, the quality and reliability of network service has become critical to telecommunications companies due to the expense, loss of customers and negative publicity resulting from poor service. Quality and reliability of network service are also important to information technology dependent businesses that rely on broadband high-speed data links for a variety of purposes.

Technicians who use service verification test equipment in the field or in central or branch offices assist businesses in verifying and repairing service problems effectively and, thus, increase the quality and reliability of their networks. We believe that as broadband services are deployed further and as competition for telecommunications subscribers and e-commerce customers proliferates, telecommunications companies and other information technology-reliant businesses will increasingly depend on new and improved integrated access and transmission devices and advanced field and central or branch office testing and monitoring solutions.

OUR SOLUTION

We develop, manufacture and market a range of electronic devices, including custom and standard electronic power supplies, digital and rotary switches, and RF and microwave devices, used primarily by aerospace, defense and

industrial customers.

We have developed and we manufacture and market a range of communication timing and synchronization products used by operators of public and private telecommunications network to provide a consistent source of timing alignment, or synchronization, for digital networks.

We have developed and we manufacture and market various network access and transmission devices used by businesses and other users to efficiently transmit data, voice and video information to destinations within and outside of their respective networks.

We have developed and we manufacture and market a select range of test instruments used by operators of telecommunications networks for the installation, maintenance and optimization of communications networks.

Our extensive knowledge and understanding of our customers' needs, together with the broad capabilities of our network access and transmission products, test instrumentation products and our sophisticated electronic devices, enable us to provide the following features and benefits to our customers:

DEVELOPMENT OF SWITCH TECHNOLOGY. We have complemented our long-established range of digital switch products with a new range of space-saving rotary switches we refer to as VLP(R), which are very low profile switches. These products have been specifically designed to target harsh environment and aerospace applications where space is at a premium, providing a substantial advantage over larger, heavier switches offered by our competitors. We have secured one patent and a number of other patents are pending relating to this technology.

PROVISION OF RF AND MICROWAVE DEVICES. We have developed and we manufacture and market a range of RF devices and microwave devices that meet the requirements of defense, aerospace and industrial applications.

DEVELOPMENT AND PROVISION OF COMMUNICATION TIMING AND SYNCHRONIZATION EQUIPMENT. We have extended the existing range of communication timing and synchronization products with a new range of equipment designed specifically to target the telephone company market in addition to private networks.

PROVISION OF MORE EFFICIENT AND COST-EFFECTIVE POWER SYSTEMS. We have developed and we provide custom and standard high and low voltage power systems that are highly integrated within the application hardware, which minimizes cost, space and complexity and maximizes overall system reliability and efficiency. We believe that our ability to partner with major international defense contractors and to provide power systems solutions based on both standard modules and custom designs provides us with an important competitive advantage.

BROAD RANGE OF NETWORK ACCESS AND TRANSMISSION PRODUCTS FOR A WIDE RANGE OF APPLICATIONS. We have developed a broad range of professional grade network access and transmission products capable of connecting to a wide range of remote monitoring devices and equipment. Many of these products are designed to operate in extended temperatures and harsh environments and meet specific requirements such as data speeds, data interfaces, power inputs, operating temperatures, data formats and power consumption. In addition, our desktop and rack mount transmission product lines allow us to serve both central site data communications needs and remote access and transmission sites on both the enterprise-wide and single location level.

COMPREHENSIVE CONNECTIVITY. Our network access and transmission products and communications test instruments are the result of significant product research and engineering and are designed to connect to a broad range of operation configurations and to connect over a wide range of prevailing transmission conditions. Our products incorporate a wide range of standard international connectivity protocols as well as proprietary protocols.

CUSTOMER-DRIVEN FEATURES. Most of our digital and rotary switches, RF and microwave devices and each of our power supplies are highly tailored to our customers' needs. We manufacture digital and rotary switches for insertion into new equipment as well as for retrofit into existing equipment. Our engineers continually interact with our customers during the design process to ensure that our electronic devices are the best available solution for them. For example, based on specifications from our customers, we delivered a compact multiple output power supply to allow BAE Systems to produce a single-heads up display suitable for fitting on a large range of commercial and military aircraft.

CUSTOMER RELATIONS. Our electronic devices business currently enjoys a preferred supplier status with many key accounts, which means that we work in close association with the customer to develop custom products specifically addressing their needs. Our electronic devices also are considered qualified products with many key accounts, which means that our products are designed into equipment specifications of many of our customers for the duration of their production of their equipment.

LONG-TERM RELATIONSHIPS. Market procurement methods encourage long-term relationships between electronic devices suppliers and customers, with customers committing to a single source of supply because of the high cost involved in qualifying a product or its alternative for use. For example, a large proportion of XPS' and Digitran's products are qualified products that have been involved in many hours of flight trials.

OUR STRATEGY

Our objectives are to become the supplier of choice for harsh environment switches, RF devices and microwave devices, and custom and standard power supplies in the aerospace, defense and industrial markets, in addition to being a leading provider of network access and transmission products and timing and synchronization systems for a broad range of applications within the global communications industry. The following are the key elements of our strategy to achieve these objectives:

FOCUS ON OUR ELECTRONIC DEVICES BUSINESS. We plan to continue to grow our electronic devices business by marketing our electronic devices in their established market niches and identifying opportunities to broaden our customer base. The primary growth driver and focus for this business segment is the in-flight multimedia and communications market for commercial airlines.

EXPAND OUR COMMUNICATION TIMING AND SYNCHRONIZATION PRODUCTS. We plan to build upon our existing strong base businesses in the communications equipment market by introducing additional new products, specifically new communication timing and synchronization products, including the recently released TiemPo(TM) 6400 product, which will be the base product in a new product range that forms the primary growth driver for this business segment.

CONTINUE TO INVEST IN RESEARCH AND DEVELOPMENT TO ADDRESS HIGH GROWTH MARKET OPPORTUNITIES. We plan to continue investing in markets and technologies that we believe offer substantial growth prospects. We believe that the

expertise we have developed in creating our existing products will permit us to enhance these products, develop new products and respond to emerging technologies in a cost-effective and timely manner.

LEVERAGE EXISTING CUSTOMER BASE. We believe that many of our existing customers will continue to purchase network access and transmission products, communication timing and synchronization products and test instrument products and services. We intend to aggressively market new and enhanced products and services to our existing customers. We also believe that our existing customer base represents an important source of references and referrals for new customers in new markets.

PURSUE FOLLOW-ON SALES OPPORTUNITIES. We plan to continue to increase the functionality of our communications equipment products, enabling products to be upgraded by the downloading of software or the addition of hardware to an existing unit, allowing customers to protect their investment in their already deployed equipment and generating follow-on sales opportunities as we develop new capabilities in the future. We plan to continue to approach our existing digital switch customers to determine whether they need our proprietary and patented rotary switches that we do not currently manufacture for them.

EMPLOY COMPETITIVE WORLD-CLASS MANUFACTURING FOR OUR PRODUCTS. We have reviewed and continue to review the manufacturing methods we use to ensure that we employ world class techniques and are competitive in the world market. We located and negotiated an agreement and currently use a Tier 1 manufacturer in the United States for our communication timing products, which provides a highly competitive and technically advanced solution to our manufacturing needs.

SEEK ALTERNATIVE MARKET OPPORTUNITIES. We plan to expand our focus and efforts to identify and capture more new customers, such as private network utilities and transit customers, for our network access and transmission products.

DEVELOP AND ExPAND STRATEGIC RELATIONSHIPS. We plan to continue to develop our strategic relationships with network access and transmission manufacturers in order to enhance our product development activities and leverage shared technologies and marketing efforts to build recognition of our brands. In particular, in Europe, we intend to continue to expand our relationships with offshore vendors as a reseller of their products to enhance our position and reputation.

PURSUE TECHNOLOGY TRANSFER AND LICENSING. We plan to continue our established practice of purchasing or licensing core technologies where this reduces time and cost to market.

DEVELOP CUSTOMER-FOCUSED SOLUTIONS. We design, develop and manufacture many products and provide services that are tailored to the specific needs of our customers with an emphasis on ease of use. We intend to continue to adapt our core communications technologies to deliver focused products that improve our customers' ability to manage increasingly larger and more complex networks.

EXTEND OUR GLOBAL PRESENCE. Our customers' needs evolve through industry expansion and consolidation as well as with the deployment of new technologies and services. To support our customers more effectively, we intend to further augment our sales, marketing and customer support organizations.

PRODUCTS AND SERVICES

Our products and services currently are divided into the following two main business segments:

- Electronic Devices
  - electronic power supplies

  - digital and rotary switches
  - RF and microwave devices
- Communications Equipment
  - network access and transmission products
  - communication timing and synchronization products
  - communications test instruments

During 2006, 2005 and 2004, our total net sales were approximately $46,384,000, $41,270,000 and $29,637,000, respectively, and the percentages of total net sales contributed by each product group within our two main business segments were as follows:

	Year Ended December 31,		
Segment and Product Type	2006	2005	2004
Electronic Devices			
Electronic Power Supplies	45.3%	34.1%	26.9%
Digital and Rotary Switches	14.1%	15.9%	18.6%
RF and Microwave Devices	8.0%	7.5%	--
Subsystem Assemblies	--	--	0.8%
Other Products and Services	3.1%	4.7%	5.2%
	70.5%	62.2%	51.5%
Communications Equipment			
Network Access and Transmission Products	17.8%	21.4%	27.9%
Communication Timing and Synchronization Products	5.9%	6.4%	4.4%
Communications Test Instruments	3.3%	7.2%	12.8%
Other Products and Services	2.5%	2.8%	3.4%
	29.5%	37.8%	48.5%
Totals	100.0%	100.0%	100.0%

BACKLOG

Our business is generally not seasonal, with the exception that purchases of our communications equipment by public telecommunications carriers tend to be lower than average during the first quarter of each year because capital equipment budgets typically are not approved until late in the first quarter. At December 31, 2006 and 2005, our backlog of firm, unshipped orders was approximately $25,784,000 and $22,150,000, respectively. At December 31, 2006, our backlog was related approximately 96% to our electronic devices business, which tends to provide us with long lead-times for our manufacturing processes due to the custom nature of the products, and approximately 4% to our communications equipment business, the majority of which portion relates to our network access and transmission and communications timing and synchronization and test equipment products. Of these backlog orders, we anticipate fulfilling approximately 70% of our electronic devices orders and 100% of our communications equipment orders within the current fiscal year. However, we cannot assure you that we will be successful in fulfilling these orders in a timely manner or that we will ultimately recognize as revenue the amounts reflected as backlog.

WARRANTIES

Generally, our electronic devices, network access and transmission products and communication timing and synchronization products carry a one-year limited parts and labor warranty and our communications test instruments and European network access and transmission products carry a two-year limited parts and labor warranty. Products returned under warranty typically are tested and repaired or replaced at our option. Historically, product returns have not had a material effect on our operations or financial condition. However, we cannot assure you that this will continue to be the case or that disputes over devices or other materials or workmanship will not arise in the future.

OUR ELECTRONIC DEVICES BUSINESS

Our electronic devices segment includes digital and rotary switches, electronic power supplies, and RF and microwave devices. During the years ended December 31, 2006, 2005 and 2004, this segment accounted for approximately 70.5%, 62.2% and 51.5%, respectively, of our total net sales.

ELECTRONIC POWER SUPPLIES

XPS and Pascall, based in England, and RO based in the U.S., manufacture a range of high and low voltage, high specification, high reliability custom and standard power conversion products designed for hostile environments and supplied to an international customer base, predominantly in the military and commercial aerospace, industrial and telecommunications markets.

Power conversion units supplied by XPS and Pascall range from 10VA to 1.3 KVA power ratings, low voltage (1V) to high voltage (20KV+), and convert alternating current, or AC, to direct current, or DC, and convert DC to AC. Units can be manufactured to satisfy input requirements determined by military, commercial aerospace, telecommunications or industrial businesses, and sophisticated built-in test equipment, or BITE, and control circuitry often is included. Operating environments for our units are diverse and range from fighter aircraft to roadside cabinets.

DIGITAL AND ROTARY SWITCHES

The Digitran division of EMRISE Electronics manufactures, assembles and sells digital and rotary switch products serving aerospace, defense and industrial applications. Digital and rotary switches are manually operated electromechanical devices used for routing electronic signals. Thumbwheel, push button, lever-actuated and rotary modules, together with assemblies comprised of multiple modules, are manufactured in many different model families. Digitran also offers a variety of custom keypads.

Our switches may be ordered with different combinations of a variety of features and options, including night vision compatibility, harsh environment sealing, RF shielding, various mounting methods, various electrical interfaces, and various packaging and presentation to suit each application.

RF AND MICROWAVE DEVICES

Pascall designs, develops, manufactures and markets a range of RF and microwave amplifiers, oscillators, multiplexers, devices, subsystems and systems for applications such as defense, aerospace, communications, air traffic control and radar.

OUR COMMUNICATIONS EQUIPMENT BUSINESS

Our communications equipment business comprises network access and transmission products, communication timing and synchronization products, and communications test equipment. During the years ended December 31, 2006, 2005 and 2004, the sale of communications equipment products and related services accounted for approximately 29.5%, 37.8% and 48.5%, respectively, of our total net sales. These products are configured in a variety of models designed to perform analog and digital measurements or to transmit data at speeds varying from low-speed voice grade transmission to high-speed broadband access.

NETWORK ACCESS AND TRANSMISSION PRODUCTS

CXR Larus and CXR-AJ design, develop, manufacture and market a broad range of network access and transmission products, including multiplexers, for fiber, copper and microwave infrastructure, which combine to provide users with a complete solution for voice and data transmission. Typical applications include secure encryption for point-of-sale and videoconferencing extension of local area networks, the consolidation of voice or data sources into a single carrier, modular routers, interface converters and voice and data transmission.

COMMUNICATION TIMING AND SYNCHRONIZATION PRODUCTS

CXR Larus designs, develops, manufactures and markets a series of communication timing and synchronization products that provide a consistent source of timing alignment, or synchronization, for digital communication networks. When the principal network timing source is lost, a CXR Larus communication timing system can provide an alternative source of reference synchronization until the principal source can be restored. This is called operating in the "holdover" state. The various levels of accuracy in holdover mode are referred to as "stratum levels." Stratum 1 is the most precise, followed by Stratum 2, Stratum 3E, Stratum 3, and finally Stratum 4. Stratum 4 has no holdover mode and is the least precise. All CXR Larus communication timing products offer Stratum 3E stability, or better, and all are available with options that meet or exceed Stratum 1.

Our range of communication timing and synchronization products include the new StarClock TiemPo 6400(TM) range; StarSyncs(TM) 5850, a GPS timing source; the StarSyncs(TM) 5800, an economical timing system designed for small installations; and the StarClock(TM) 200, specifically designed for central office applications.

The TiemPo(TM) 6400 is a fully-integrated, modular and scalable system for timing and synchronization of current and next generation packet networks. It provides flexible and cost-effective solutions for timing and synchronization of telecommunications equipment and meets or exceeds all relevant North American and European telecommunications standards. The TiemPo(TM) 6400 incorporates a new, proprietary, scalable architecture, providing many advanced features that address the needs of a broad range of customers and markets, including all telecommunications providers as well as numerous enterprise and military applications. The TiemPo(TM) 6400 features CXR Larus' new Element Management System, StarLink(TM), for remote network monitoring and management, and will also provide an interface to other industry leading element and network management systems. For smaller standalone applications, a new simple to use graphical user interface, CXRView(TM), is provided.

COMMUNICATIONS TEST INSTRUMENTS

CXR Larus manufactures the CXR HALCYON 700 series of products, which we believe provide performance and value in integrated installation, maintenance and testing of communications services. These test instruments are modular, rugged, lightweight, hand-held products used predominantly by telephone

companies and private network operators to pre-qualify facilities for services, verify proper operation of newly installed services and diagnose problems. The modular nature of our CXR HALCYON 700 series test equipment provides an easy configuration and upgrade path for testing of the specific services offered by the various national and international service providers.

CUSTOMERS

ELECTRONIC DEVICES

We sell our electronic devices primarily to original equipment manufacturers, or OEMs, in the electronics industry, including manufacturers of aerospace and defense systems and industrial instruments. During 2006, our top five electronic devices customers in terms of revenues were Rockwell Collins, Inc., Selex Airborne Systems, BAE Systems, EMS Technologies, AB Pharos Systems Company and Raytheon Systems Company. Sales to Rockwell Collins represented approximately 9% of our total net sales during 2006 and 10% during 2005. No other customer represented 10% or more of our total net sales during those periods.

COMMUNICATIONS EQUIPMENT

We market our network access and transmission products, communication timing and synchronization products and communications test instruments primarily to public, private and corporate telecommunications service providers and end users. Typically, communications service providers use a variety of network equipment and software to originate, transport and terminate communications sessions. Communications service providers rely on our products and services as elements of the communications infrastructure and to configure,

test and manage network elements and the traffic that runs across them. Also, our products help to ensure smooth operation of the network and increase the reliability of services to customers.

The major communications service providers to whom we market these products and services include telephone companies, inter-exchange carriers, incumbent local exchange carriers, competitive local exchange carriers, Internet service providers, integrated communications providers, cable service providers, international post, telephone and telegraph companies, banks, brokerage firms, government agencies and other service providers. During 2006, our top five communications test instruments, network access and transmission products and communication timing and synchronization products customers in terms of our net sales were Power & Telephone, Harris Corporation, ITT, Graybar and ARINC, Inc. None of our communications equipment customers represented 10% or more of our revenues during 2006.

Because we currently derive some of our revenues from sales to telephone companies and other telecommunications service providers, we have experienced and will continue to experience for the foreseeable future an effect on our quarterly operating results due to the budgeting cycles of telephone companies. Telephone companies generally obtain approval for their annual budgets during the first quarter of each calendar year. If a telephone company's annual budget is not approved early in the calendar year or is insufficient to cover its desired purchases for the entire calendar year, we are unable to sell products to the telephone company during the period of the delay or shortfall.

SALES, MARKETING AND CUSTOMER SUPPORT

ELECTRONIC DEVICES

We market and sell our electronic devices through Digitran, XPS, Pascall, RO and XCEL Japan, Ltd., a wholly-owned subsidiary of EMRISE Electronics based in Japan. In some European countries and the Pacific Rim, these products are sold through a combination of direct sales and through third-party distributors.

We sell our electronic devices primarily to OEMs and system integrators in the aerospace and electronics industries, including manufacturers of aerospace and military systems and industrial instruments. Our electronic devices business typically has long-term relationships with its customer base, with projects and programs that are multi-year and with military programs in excess of ten years.

XCEL Japan, Ltd. resells Digitran's digital and rotary switches and keypad products and some third-party-sourced devices primarily into Japan and also into other highly industrialized Asian countries. Marketing of our electronic devices is primarily through referrals from our existing customers, with sales either direct or via a small number of selected independent sales representatives.

We rely on long-term orders and repeat business from our existing customers. We also approach our existing customers and their competitors to discuss opportunities for us to provide them with subsystem assemblies that typically incorporate our own products. Each of our devices businesses has an extensive installed base: Digitran's history spans over 40 years in the electronic devices industry, XPS, 50 years and RO 40 years. Major OEMs have designed many of our switches, power supplies and RF and microwave devices into their established product specifications. These factors have frequently resulted in customers seeking us out to manufacture for them unique subsystem assemblies

as well as special variations of our standard digital switches.

COMMUNICATIONS EQUIPMENT

Our sales and marketing staff consist primarily of engineers and technical professionals. Our staff undergo extensive training and ongoing professional development and education. We believe that the skill level of our sales and marketing staff has been instrumental in building long-standing customer relationships. In addition, our frequent dialogue with our customers provides us with valuable input on systems and features they desire in future products. We believe that our consultative sales approach and our product and market knowledge differentiate our sales forces from those of our competitors.

Our local sales forces are highly knowledgeable about their respective markets, customer operations and strategies and regulatory environments. In addition, the familiarity of members of our sales force with local languages and customs enables them to build close relationships with our customers.

We provide repair and training services to enable our customers to improve performance of their networks. We also offer on-line support services to supplement our on-site application engineering support. Customers can also access information regarding our products remotely through our domestic, European and Japanese technical assistance centers.

We sell many of our communications equipment products to large telecommunications service providers as well as through distributors, resellers and value added resellers. Telecommunications service providers generally commit significant resources to an evaluation of our and our competitors' products and require each vendor to expend substantial time, effort and money educating them about the value of the vendor's solutions. Consequently, sales to this type of customer generally require an extensive sales effort throughout the prospective customer's organization and final approval by an executive officer or other senior level employee. The result is lengthy sales and approval cycles, which make sales forecasting difficult. In addition, even after a large telecommunications service provider has approved our product for purchase, their future purchases are uncertain because while we generally enter into long-term supply agreements with those parties, these agreements do not require specific levels of purchases.

Delays associated with potential customers' internal approval and contracting procedures, procurement practices, testing and acceptance processes are common and may cause potential sales of our communications products and test equipment to be delayed or foregone. As a result of these and related factors, the sales cycle of new products for large customers typically ranges from six to twelve months or more. In addition to the latter case, we also have some distribution channels that generally are box stocking distributors with significant independent sales forces selling our products to final customers, integrators and other resellers on a regional and nationwide basis. We perform product applications training for the distributor and reseller workforce and funnel many of the leads we generate to the distribution channels for their follow-up and closure.

COMPETITION

ELECTRONIC DEVICES

The market for our devices is highly fragmented and composed of a diverse group of OEMs, including Power One, Interpoint/Grenson, Martek and Celab Ltd. for power supplies; Esterline (Janco), Greyhill, Inc., Omron Electronics, Transico Inc. and C&K Components Inc. for digital and rotary switches; and Elisera, AML and American Microwave Corporation for RF and microwave devices. We believe that the principal competitive factors affecting our devices business include: o capability and quality of product offerings; o status as qualified products; and o compliance with government and industry standards.

We have made substantial investments in machinery and equipment in our digital and rotary switch and power supply operations. In addition, Digitran's long history in the electronic devices industry and the fact that major OEMs have designed many of our digital switches into their product specifications have acted as barriers to entry for other potential competitors and aided us in establishing and maintaining both distribution channels and customers for our products by making us a sole source supplier for approximately 30% to 50% of the digital switches that we sell and have caused some customers to seek us out to manufacture for them unique as well as our standard digital and rotary switches.

Some of our competitors have greater sales, marketing, technological, research and financial resources than we do. Our competitors' advantage with regard to these resources may reduce our ability to obtain or maintain market share for our products in cases where our competitors are better able than we are to satisfy the above competitive factors.

COMMUNICATIONS EQUIPMENT

The markets for our communications equipment and services are fragmented and intensely competitive, both inside and outside the United States, and are subject to rapid technological change, evolving industry standards and regulatory developments. We believe that the principal competitive factors affecting our communications equipment business include:

- quality of product offerings;
- adaptability to evolving technologies and standards;
- ability to address and adapt to individual customer requirements;

- price and financing terms;
- strength of distribution channels;
- ease of installation, integration and use of products;
- system reliability and performance; and
- compliance with government and industry standards.

Our principal competitors for our communications equipment include Symmetricom, Frequency Electronics and Oscilloquartz for communication timing and synchronization products; RAD, Zhone/Paradyne and Patton Electronics Corporation for network access and transmission products; and TTC Corporation (a subsidiary of JDS Uniphase), Ameritec Corporation, Fluke, Sunrise Telecom, Inc. and Electrodata, Inc. for communications test instruments.

The design of many of our network access and transmission products enables us to offer numerous product combinations to our customers and to serve both central site data communications needs and remote access and transmission sites on both the enterprise-wide and single location level. We believe that this design flexibility helps us to excel at many of the above competitive factors by enabling us to offer quality products that meet and are adaptable to evolving customer requirements, technologies and government and industry standards.

We currently derive a significant portion of our revenues from sales to telephone companies. We believe we derive a competitive advantage from efforts we expended to establish many of our communications equipment products as customer-approved products for telephone companies and for other key customers in the United States and abroad. Our products' approved status facilitates the ability of our customers to order additional products from us as their needs arise without the long delays that might otherwise be needed to obtain the approval of our customers' upper management or governing body prior to each purchase.

Some of our competitors have greater sales, marketing, technological, research and financial resources than we do. Our competitors' advantage with regard to these resources may reduce our ability to obtain or maintain market share for our products in cases where our competitors are better able than we are to satisfy the above competitive factors.

MANUFACTURING, ASSEMBLY AND QUALITY ASSURANCE

Our network access and transmission products, communication timing and synchronization products and communications test instruments generally are assembled from outsourced subassemblies, with final assembly, configuration and quality testing performed in house.

Manufacturing of our electronic devices, including injection molding, fabrication, machining, printed circuit board assembly, and quality testing is done in house due to the specialized nature and small and varied batch sizes involved. Although many of our electronic devices incorporate standard designs and specifications, products are nevertheless built to customer order. This approach, which avoids the need to maintain a large finished goods inventory, is possible because of the custom nature of the products. Typically, our electronic devices segment produces products in one- to 300-piece batches, with a ten- to thirty-week lead-time. The lead-time is predominantly to source sub-component piece parts such as electronic components, mechanical components and services. Typical build time is six to eight weeks from receipt of external components.

13

We operate seven manufacturing and assembly facilities worldwide. All of these facilities except the RO Associates facility, which is being submitted for accreditation, are certified as ISO 9001- or 9002-compliant. We manufacture our network access and transmission products at CXR-AJ's facilities in France and at CXR Larus' facility in San Jose, California. We manufacture RF and microwave devices and custom power supplies at Pascall's facility in Ryde, Isle of Wight, England. We manufacture standard power supplies at RO's facility in Sunnyvale, California. We manufacture all of our test equipment and communication timing and synchronization products at the San Jose facility. We manufacture all of our digital and rotary switches in EMRISE Electronics Corporation's Rancho Cucamonga, California facility. We manufacture our custom electronic power supplies in Ashford, Kent, England and Ryde, Isle of Wight, England.

The purchased components we use to build our products are generally available from a number of suppliers. We rely on a number of limited-source suppliers for specific components and parts. We do not have long-term supply agreements with these vendors. In general, we make advance purchases of some components to ensure an adequate supply, particularly for products that require lead-times of up to nine months to manufacture. If we were required to locate new suppliers or additional sources of supply, we could experience a disruption in our operations or incur additional costs in procuring required materials.

We intend to increase the use of outsource manufacturing for our communications equipment products. We believe that outsourcing will lower our manufacturing costs, in particular our components and labor costs, provide us with more flexibility to scale our operations to meet changing demand, and allow us to focus our engineering resources on new product development and product enhancements.

PRODUCT DEVELOPMENT AND ENGINEERING

We believe that our continued success depends on our ability to anticipate and respond to changes in the electronics hardware industry and anticipate and satisfy our customers' preferences and requirements. We continually review and evaluate technological and regulatory changes affecting the electronics hardware industry and seek to offer products and capabilities that solve customers' operational challenges and improve their efficiency.

For the years ended December 31, 2006, 2005 and 2004, our engineering and product development costs were approximately $3,085,000, $2,621,000 and $1,521,000, respectively.

Our product development costs during the past three years were related to development of new communication timing and synchronization products, communication network access products, development of a new line of rotary switches at our Digitran facility and the development of RF and microwave devices at Pascall. We have continued incurring engineering costs applicable to the development of new digital and rotary switches since 2001. Current research expenditures in the communications equipment segment are directed principally toward the expansion of our range of network access and transmission products and the development and expansion of our range of communication timing and synchronization systems. These expenditures are intended to improve market share and gross profit margins, although we cannot assure you that we will achieve these improvements.

We strive to take advantage of the latest computer-aided engineering and engineering design automation workstation tools to design, simulate and test advanced product features or product enhancements. Our use of these tools helps us to speed product development while maintaining high standards of quality and reliability for our products. Our use of these tools also allows us to efficiently offer custom designs for OEM customers whose needs require the integration of our electronic devices with their own products.

INTELLECTUAL PROPERTY

We regard our software, hardware and manufacturing processes as proprietary and rely on a combination of patent, copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our proprietary rights. We have secured a U.S. and foreign patent for a rotary

switch product and we filed patent applications, and intend to file additional patent applications in the future, for various other products with the U.S. Patent and Trademark Office and in the European Union, Japan, Canada and Brazil. We seek to protect our software, documentation and other written materials under trade secret and copyright laws, which afford some limited protection. The laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. Our research and development and manufacturing process typically involves the use and development of a variety of forms of intellectual property and proprietary technology. In addition, we incorporate technology and software that we license from third party sources into our products. These licenses generally involve a one-time fee and no time limit. We believe that alternative technologies for this licensed technology are available both domestically and internationally.

We may receive in the future notices from holders of patents that raise issues as to possible infringement by our products. As the number of network access, transmission and communication timing and synchronization instruments increases and the functionality of these products further overlaps, we believe that we may become subject to allegations of infringement given the nature of the telecommunications and information technology industries and the high incidence of these kinds of claims. Questions of infringement and the validity of patents in the fields of telecommunications and information technology involve highly technical and subjective analyses. These kinds of proceedings are time consuming and expensive to defend or resolve, result in substantial diversion of management resources, cause product shipment delays or could force us to enter into royalty or license agreements rather than dispute the merits of the proceeding initiated against us.

GOVERNMENT REGULATION AND INDUSTRY STANDARDS AND PROTOCOLS

We design our products to comply with a significant number of industry standards and regulations, some of which are evolving as new technologies are deployed. In the United States, our products must comply with various regulations defined by the United States Federal Communications Commission, or FCC, and Underwriters Laboratories as well as industry standards such as NEBS established by Telcordia Technologies, Inc., formerly Bellcore, and those developed by the American National Standards Institute. Internationally, our products must comply with standards established by the European Committee for Electrotechnical Standardization, the European Committee for Standardization, the European Telecommunications Standards Institute and telecommunications authorities in various countries, as well as with recommendations of the International Telecommunications Union. The failure of our products to comply, or delays in compliance, with the various existing and evolving standards could negatively affect our ability to sell our products.

Our product lines are subject to statutes governing safety and environmental protection. We believe that we are in substantial compliance with these statutes and are not aware of any proposed or pending safety or environmental rule or regulation that, if adopted, would have a material effect on our business or financial condition.

EMPLOYEES

As of March 16, 2007, we employed approximately 305 persons in our various divisions and subsidiaries. None of our employees are represented by labor unions, and there have not been any work stoppages at any of our facilities. We believe that our relationship with our employees is good.

ITEM 1A. RISK FACTORS.

RISK FACTORS

THE FOLLOWING SUMMARIZES MATERIAL RISKS THAT INVESTORS SHOULD CAREFULLY CONSIDER BEFORE DECIDING TO BUY OR MAINTAIN AN INVESTMENT IN OUR COMMON STOCK. ANY OF THE FOLLOWING RISKS, IF THEY ACTUALLY OCCUR, WOULD LIKELY HARM OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS. AS A RESULT, THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE, AND INVESTORS COULD LOSE THE MONEY THEY PAID TO BUY OUR COMMON STOCK.

WE INCURRED A NET LOSS IN 2006 AND MAY INCUR LOSSES IN THE FUTURE. IF WE CONTINUE TO INCUR LOSSES, WE WILL EXPERIENCE NEGATIVE CASH FLOW, WHICH MAY HAMPER OUR OPERATIONS, MAY PREVENT US FROM EXPANDING OUR BUSINESS AND MAY CAUSE OUR STOCK PRICE TO DECLINE.

We incurred a $3,938,000 net loss for 2006. We expect to rely on cash on hand, cash generated from our operations and existing and future financing activities to fund the cash requirements of our business. If our net losses continue, we will experience negative cash flow, which may hamper current operations and may prevent us from expanding our business. We may be unable to attain, sustain or increase profitability on a quarterly or annual basis in the future. If we do not achieve, sustain or increase profitability, our stock price may decline.

OUR LACK OF LONG-TERM PURCHASE ORDERS OR COMMITMENTS MAY ADVERSELY AFFECT OUR BUSINESS IF DEMAND IS REDUCED.

During 2006, the sale of electronic devices accounted for approximately 70.5% of our total net sales, and the sale of communications equipment and related services accounted for approximately 29.5% of our total net sales. In many cases we have long-term contracts with our electronic devices and communications equipment customers that cover the general terms and conditions of our relationships with them but that do not include long-term purchase orders or commitments. Rather, our customers issue purchase orders requesting the quantities of communications equipment they desire to purchase from us, and if we are able and willing to fill those orders, then we fill them under the terms of the contracts. Accordingly, we cannot rely on long-term purchase orders or commitments to protect us from the negative financial effects of reduced demand for our products that could result from a general economic downturn, from changes in the electronic devices and communications equipment industries, including the entry of new competitors into the market, from the introduction by others of new or improved technology, from an unanticipated shift in the needs of our customers, or from other causes.

THE UNPREDICTABILITY OF OUR QUARTERLY OPERATING RESULTS MAY CAUSE THE PRICE OF OUR COMMON STOCK TO FLUCTUATE OR DECLINE.

Our quarterly operating results have varied significantly in the past and will likely continue to do so in the future due to a variety of factors, many of which are beyond our control. Our operating results from our communications segment tend to be less stable and predictable than our operating results from our electronic devices segment.

The cyclical nature of the telecommunications business due to the budgetary cycle of telephone companies has had and will continue to have for the foreseeable future an effect on our quarterly operating results. Telephone companies generally obtain approval for their annual budgets during the first quarter of each calendar year. If a telephone company's annual budget is not approved early in the calendar year or is insufficient to cover its desired

purchases for the entire calendar year, we are unable to sell products to the telephone company during the period of the delay or shortfall.

Our electronic devices sales are often made in conjunction with military contracts. The timing of required deliveries under these contracts can be delayed based on issues related to the overall military contract, which can cause delays in our shipment schedules and revenue recognition.

Quarter to quarter fluctuations may also result from the uneven pace of technological innovation, the development of products responding to these technological innovations by us and our competitors, our customers' acceptance of these products and innovations, the varied degree of price, product and technological competition and our customers' and competitors' responses to these changes.

Due to these factors and other factors, including changes in general economic conditions, we believe that period-to-period comparisons of our operating results will not necessarily be meaningful in predicting future performance. If our operating results do not meet the expectations of investors, our stock price may fluctuate or decline.

MANY OF OUR COMPETITORS HAVE GREATER RESOURCES THAN US. IN ORDER TO COMPETE SUCCESSFULLY, WE MUST KEEP PACE WITH OUR COMPETITORS IN ANTICIPATING AND RESPONDING TO THE RAPID CHANGES INVOLVING THE ELECTRONIC DEVICES AND COMMUNICATIONS EQUIPMENT INDUSTRIES.

Our future success will depend upon our ability to enhance our current products and services and to develop and introduce new products and services that keep pace with technological developments, respond to the growth in the electronic devices and communications equipment markets in which we compete, encompass evolving customer requirements, provide a broad range of products and achieve market acceptance of our products. Many of our existing and potential competitors have larger technical staffs, more established and larger marketing and sales organizations and significantly greater financial resources than we do. Our lack of resources relative to our competitors may cause us to fail to anticipate or respond adequately to technological developments and customer requirements or to experience significant delays in developing or introducing new products and services. These failures or delays could reduce our competitiveness, revenues, profit margins or market share.

WE RELY HEAVILY ON OUR MANAGEMENT, AND THE LOSS OF THEIR SERVICES COULD ADVERSELY AFFECT OUR BUSINESS.

Our success is highly dependent upon the continued services of key members of our management, including Carmine T. Oliva, our Chairman of the Board, President, and Chief Executive Officer, Acting Chief Financial Officer and Secretary, and Graham Jefferies, our Executive Vice President and Chief Operating Officer. Mr. Oliva co-founded EMRISE Electronics and has developed personal contacts and other skills that we rely upon in connection with our financing, acquisition and general business strategies. Mr. Jefferies is a long-time employee of EMRISE who we have relied upon in connection with our United Kingdom acquisitions and who fulfills significant operational responsibilities in connection with our foreign and domestic operations. The loss of Mr. Oliva, Mr. Jefferies, or one or more other key members of management could adversely affect us. Although we have entered into employment agreements with each of our executive officers, those agreements are of limited duration

and are subject to early termination by the officers under some circumstances. We maintain key-man life insurance on Mr. Oliva and Mr. Jefferies. However, we cannot assure you that we will be able to maintain this insurance in effect or that the coverage will be sufficient to compensate us for the loss of the services of Mr. Oliva or Mr. Jefferies.

IF WE ARE UNABLE TO SUCCESSFULLY IDENTIFY OR MAKE STRATEGIC ACQUISITIONS, OUR LONG-TERM COMPETITIVE POSITIONING MAY SUFFER.

Our business strategy includes growth through acquisitions that we believe will improve our competitive capabilities or provide additional market penetration or business opportunities in areas that are consistent with our

business plan. Identifying and pursuing strategic acquisitions and integrating acquired products and businesses requires a significant amount of management time and skill. Acquisitions may also require us to expend a substantial amount of cash or other resources, not only as a result of the direct expenses involved in the acquisition transaction, but also as a result of ongoing research and development activities that may be required to maintain or enhance the long-term competitiveness of acquired products, particularly those products marketed to the rapidly evolving telecommunications industry. If we are unable to make strategic acquisitions due to our inability to identify appropriate targets, or to manage the difficulties or costs involved in the acquisitions, our long-term competitive positioning may suffer.

IF WE ARE UNABLE TO FULFILL BACKLOG ORDERS DUE TO CIRCUMSTANCES INVOLVING US OR ONE OR MORE OF OUR SUPPLIERS OR CUSTOMERS, OUR ANTICIPATED RESULTS OF OPERATIONS WILL SUFFER.

As of December 31, 2006, we had $25,784,000 in backlog orders for our products. Backlog orders represent 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 with respect to which work is currently in progress. Our backlog orders are due in large part to the long lead-times associated with our electronic devices products, which products generally are custom built to order. We cannot assure you that we will be successful in fulfilling orders and commitments in a timely manner or that we will ultimately recognize as revenue the amounts reflected as backlog. Factors that could affect our ability to fulfill backlog orders include difficulty we may experience in obtaining devices from suppliers, whether due to obsolescence, production difficulties on the part of suppliers or other causes, or customer-induced delays and product holds. Our anticipated results of operations will suffer to the extent we are unable to fulfill backlog orders within the timeframes we establish, particularly if delays in fulfilling backlog orders cause our customers to reduce or cancel their orders.

IF OUR PRODUCTS FAIL TO COMPLY WITH EVOLVING GOVERNMENT AND INDUSTRY STANDARDS AND REGULATIONS, WE MAY HAVE DIFFICULTY SELLING OUR PRODUCTS.

We design our products to comply with a significant number of industry standards and regulations, some of which are evolving as new technologies are deployed. In the United States, our communications equipment products must comply with various regulations defined by the FCC and Underwriters Laboratories as well as industry standards established by Telcordia Technologies, Inc. and the American National Standards Institute, among others. Internationally, our communications equipment products must comply with standards established by the

European Committee for Electrotechnical Standardization, the European Committee for Standardization, the European Telecommunications Standards Institute, telecommunications authorities in various countries as well as with recommendations of the International Telecommunications Union, among others. The failure of our products to comply, or delays in compliance, with the various existing and evolving standards could negatively affect our ability to sell our products.

OUR BUSINESS COULD SUFFER IF WE ARE UNABLE TO OBTAIN COMPONENTS OF OUR PRODUCTS FROM OUTSIDE SUPPLIERS.

The major components of our products include circuit boards, microprocessors, chipsets and memory components. Most of these components are available from multiple sources. However, we currently obtain some components used in our products from single or limited sources. Some modem chipsets used in our data communications equipment products have been in short supply and are frequently on allocation by semiconductor manufacturers. We have, from time to time, experienced difficulty in obtaining some components. We do not have guaranteed supply arrangements with any of our suppliers, and there can be no assurance that our suppliers will continue to meet our requirements. Further, disruption in transportation services as a result of enhanced security measures in response to terrorism threats or attacks may cause some increases in costs and timing for both our receipt of components and shipment of products to our customers. If our existing suppliers are unable to meet our requirements, we could be required to alter product designs to use alternative components or, if alterations are not feasible, we could be required to eliminate products from our product line.

Shortages of components could not only limit our product line and production capacity but also could result in higher costs due to the higher costs of components in short supply or the need to use higher cost substitute components. Significant increases in the prices of components could adversely affect our results of operations because our products compete on price and, therefore, we may not be able to adjust product pricing to reflect the increases in component costs. Also, an extended interruption in the supply of components or a reduction in their quality or reliability would adversely affect our financial condition and results of operations by impairing our ability to timely deliver quality products to our customers. Delays in deliveries due to shortages of components or other factors may result in cancellation by our customers of all or part of their orders. Although customers who purchase from us products, such as many of our digital switches and all of our custom power supplies, that are not readily available from other sources would be less likely than other customers of ours to cancel their orders due to production delays, we cannot assure you that cancellations would not occur.

FINANCIAL STATEMENTS OF OUR FOREIGN SUBSIDIARIES ARE PREPARED USING THE RELEVANT FOREIGN CURRENCY THAT MUST BE CONVERTED INTO UNITED STATES DOLLARS FOR INCLUSION IN OUR CONSOLIDATED FINANCIAL STATEMENTS. AS A RESULT, EXCHANGE RATE FLUCTUATIONS MAY ADVERSELY AFFECT OUR REPORTED RESULTS OF OPERATIONS.

We have established and acquired international subsidiaries in the United Kingdom, France and Japan that prepare their balance sheets in the relevant foreign currency. In order to be included in our consolidated financial statements, these balance sheets are converted, at the then current exchange rate, into United States dollars, and the statements of operations are converted

using weighted average exchange rates for the applicable period. Accordingly, fluctuations of the foreign currencies relative to the United States dollar could affect our consolidated financial statements. Our exposure to fluctuations in currency exchange rates has increased as a result of the growth of our international subsidiaries. Sales of our products and services to customers located outside of the United States accounted for approximately 50.2% and 49.7% of our net sales for 2006 and 2005, respectively. We use derivatives to manage foreign currency rate risk for certain sales shipped from the United Kingdom. Our ultimate realized gain or loss with respect to currency fluctuations will depend on the currency exchange rates and other factors in effect as the contracts mature. Net foreign exchange translation gains and losses included in other income and expense in our consolidated statements of operations totaled a $343,000 loss for 2006 and a $123,000 gain for 2005.

BECAUSE WE BELIEVE THAT PROPRIETARY RIGHTS ARE MATERIAL TO OUR SUCCESS, MISAPPROPRIATION OF THESE RIGHTS COULD ADVERSELY AFFECT OUR FINANCIAL CONDITION.

Our future success will be highly dependent on proprietary technology, particularly in our communications equipment business. However, we do not hold any patents and we currently rely on a combination of contractual rights, copyrights, trademarks and trade secrets to protect our proprietary rights. Our management believes that because of the rapid pace of technological change in the industries in which we operate, the legal intellectual property protection for our products is a less significant factor in our success than the knowledge, abilities and experience of our employees, the frequency of our product enhancements, the effectiveness of our marketing activities and the timeliness and quality of our support services. Consequently, we rely to a great extent on trade secret protection for much of our technology. However, there can be no assurance that our means of protecting our proprietary rights will be adequate or that our competitors or customers will not independently develop comparable or superior technologies or obtain unauthorized access to our proprietary technology. Our financial condition would be adversely affected if we were to lose our competitive position due to our inability to adequately protect our proprietary rights as our technology evolves.

OUR COMMON STOCK PRICE HAS BEEN VOLATILE, WHICH COULD RESULT IN SUBSTANTIAL LOSSES FOR INVESTORS PURCHASING SHARES OF OUR COMMON STOCK AND IN LITIGATION AGAINST US.

The market prices of securities of technology-based companies currently are highly volatile. The market price of our common stock has fluctuated significantly in the past. During 2006, the high and low closing sale prices of a share of our common stock were $1.55 and $0.66, respectively. Between January 1, 2007 and March 16, 2007, the high and low closing sale prices of a share of our common stock were $1.55 and $1.05, respectively. The market price of our common stock may continue to fluctuate in response to the following factors, many of which are beyond our control:

- changes in market valuations of similar companies and stock market price and volume fluctuations generally;

- economic conditions specific to the electronic devices or communications equipment industries;

- announcements by us or our competitors of new or enhanced products,

technologies or services or significant contracts, acquisitions, strategic relationships, joint ventures or capital commitments;

- delays in our introduction of new products or technological innovations or problems in the functioning of these new products or innovations;
- third parties' infringement of our intellectual property rights;
- changes in our pricing policies or the pricing policies of our competitors;
- foreign currency translations gains or losses;
- regulatory developments;
- fluctuations in our quarterly or annual operating results;
- additions or departures of key personnel; and
- future sales of our common stock or other securities.

The price at which you purchase shares of common stock may not be indicative of the price of our stock that will prevail in the trading market. You may be unable to sell your shares of common stock at or above your purchase price, which may result in substantial losses to you. Moreover, in the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources.

FUTURE SALES OF SHARES OF OUR COMMON STOCK BY OUR STOCKHOLDERS COULD CAUSE OUR STOCK PRICE TO DECLINE.

We cannot predict the effect, if any, that market sales of shares of our common stock or the availability of shares of common stock for sale will have on the market price prevailing from time to time. As of March 16, 2007, we had

outstanding 38,136,750 shares of common stock and options and warrants to purchase an aggregate of 6,071,633 shares of common stock. A substantial number of these shares are eligible for public resale. Sales of shares of our common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decrease or to be lower than it might be in the absence of those sales or perceptions.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

ITEM 2. PROPERTIES.

As of March 16, 2007, we leased or owned approximately 173,000 square feet of administrative, engineering, production, storage and shipping space. All of this space was leased other than the Abondant, France facility, which is owned.

BUSINESS UNIT	LOCATION	FU LEASE EX
EMRISE Corporation (corporate headquarters)	Rancho Cucamonga, California	Administratio Expires Octob
EMRISE Electronics Corporation/Digitran (electronic devices)	Rancho Cucamonga, California	Administratio Manufacturing Expires Novem
XCEL Power Systems, Ltd. and EEL (electronic devices)	Monrovia, California Ashford, Kent, England	Expires Febru Administratio Manufacturing 2013
XCEL Japan, Ltd. (electronic devices)	Tokyo, Japan	Sales; Expires Decem
RO (power supplies)	Sunnyvale, California	Administrativ Manufacturing Month-to-mont was terminate
Pascall Electronics Limited (RF and microwave devices and custom power supplies)	Ryde, Isle of Wight, England	Administratio Manufacturing Expires May 2

BUSINESS UNIT	LOCATION	FU LEASE EX
CXR-AJ (network access and transmission products)	Paris, France	Administratio Expires April
CXR-AJ (network access and transmission products)	Abondant, France	Administratio Manufacturing
CXR Larus (network access and transmission products, communications test instruments, communication timing and synchronization products)	San Jose, California	Administratio Manufacturing Expires June renewable

We believe the listed facilities are adequate for our current business operations. We recently consolidated our RO operations into our CXR Larus facility in San Jose, California and terminated our lease for RO's Sunnyvale, California premises effective March 31, 2007. Also, CXR-AJ recently moved to a new facility and entered into a new lease to replace the Paris, France lease that was to expire in April 2007.

ITEM 3. LEGAL PROCEEDINGS.

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

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2006.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

MARKET PRICE AND HOLDERS

Our common stock has traded on NYSE Arca since March 8, 2006, under the symbol "ERI." For the period from August 10, 2005 through March 7, 2006, our common stock traded on the Archipelago Exchange(SM) (ArcaEx(R)), a facility of the Pacific Exchange(R), under the symbol "ERI." Prior to that, our common stock traded on the OTC Bulletin Board under the symbol "EMRI." The table below shows, for each fiscal quarter indicated, the high and low sales prices on NYSE Arca and the Pacific Exchange and the high and low closing bid prices on the OTC Bulletin Board, as the case may be, for shares of our common stock. The prices shown reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

	High	Low
Year Ended December 31, 2005		
First Quarter	$1.82	$1.46
Second Quarter	1.51	1.08
Third Quarter	1.98	0.91
Fourth Quarter	2.34	1.14
Year Ended December 31, 2006		
First Quarter	$1.55	$0.94
Second Quarter	1.14	0.74
Third Quarter	1.15	0.66
Fourth Quarter	1.10	0.89

As of March 16, 2007, we had outstanding 38,136,750 shares of common stock outstanding held of record by approximately 3,000 stockholders. These holders of record include depositories that hold shares of stock for brokerage firms which, in turn, hold shares of stock for numerous beneficial owners. On March 16, 2007, the closing sale price of our common stock on NYSE Arca was $1.12 per share.

DIVIDENDS

We have not declared or paid any cash dividends on our capital stock in the past, and we do not anticipate declaring or paying cash dividends on our common stock in the foreseeable future.

We will pay dividends on our common stock only if and when declared by our board of directors. Our board of directors' ability to declare a dividend is subject to restrictions imposed by Delaware law. In determining whether to declare dividends, the board of directors will consider these restrictions as well as our financial condition, results of operations, working capital requirements, future prospects and other factors it considers relevant.

PERFORMANCE GRAPH

Set forth below is a line graph comparing the cumulative total stockholder return on our common stock, based on its market price, with the cumulative total return on companies on the Nasdaq Stock Market (U.S.) and the Nasdaq Electronic Components Index, assuming reinvestment of dividends for the period beginning December 31, 2001 and ending December 31, 2006. This graph assumes that the value of the investment in our common stock and each of the comparison groups was $100 on December 31, 2001.

[PERFORMANCE GRAPH]

	Cumulative Total Return ($)			
	12/01	12/02	12/03	12/04
EMRISE CORPORATION	100.00	64.52	362.90	545.16
NASDAQ STOCK MARKET (U.S.)	100.00	71.97	107.18	117.07
NASDAQ ELECTRONIC COMPONENTS	100.00	64.40	92.31	100.78

ITEM 6. SELECTED FINANCIAL DATA.

The selected consolidated financial data presented below for each of the five years in the period ended December 31, 2006 have been derived from audited financial statements that for the most recent three years appear elsewhere herein. The data presented below should be read in conjunction with such financial statements, including the related notes thereto and the other information included herein. The historical results are not necessarily indicative of results to be expected for any future periods.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME DATA:	YEARS ENDED DECEMBER 31,			
	2006	2005	2004	2003
	(IN THOUSANDS, EXCEPT PER SHARE AM			
Net sales....................................	$ 46,384	$ 41,270	$ 29,637	$ 25,51
Cost of sales................................	29,413	23,714	16,089	14,83
Gross profit.................................	16,971	17,556	13,548	10,68
Selling, general and administrative expenses...	16,117	13,707	10,212	7,81
Engineering and product development expenses..	3,085	2,621	1,521	95
(Loss) income from operations.................	(2,231)	1,228	1,815	1,92
Total other expense...........................	(765)	(54)	(439)	(47

(Loss) income from continuing operations before income taxes	(2,996)	1,174	1,376	1,44
Income tax (benefit) expense	619	(267)	49	28
Net (loss) income	(3,615)	1,441	1,327	1,16
Foreign currency translation adjustment	1,568	(1,357)	379	70
Total comprehensive income (loss)	$ (2,047)	$ 84	$ 1,706	$ 1,86
Basic (loss) earnings per share	$ (0.10)	$ 0.04	$ 0.06	$ 0.0
Diluted (loss) earnings per share	$ (0.10)	$ 0.04	$ 0.05	$ 0.0
Weighted average shares outstanding, basic	37,981	37,253	24,063	22,56
Weighted average shares outstanding, diluted	37,981	38,386	24,839	23,81

	YEARS ENDED DECEMBER 31,			
	2006	2005	2004	2003
BALANCE SHEET DATA:			(IN THOUSANDS)	
Cash and cash equivalents	$ 3,802	$ 4,371	$ 1,057	$ 1,17
Working capital	9,611	12,958	5,357	5,69
Total assets	44,785	44,461	25,144	17,16
Long-term debt, net of current portion	1,783	2,492	3,208	81
Stockholders' equity	25,173	27,013	10,757	7,91
Convertible redeemable preferred stock	--	--	--	-

24

No cash dividends on our common stock were declared during any of the periods presented above. Various factors materially affect the comparability of the information presented in the above table. These factors relate primarily to the acquisition of Larus Corporation in July 2004, the acquisition of Pascall in March 2005, the acquisition of RO in August 2005, and changes in foreign currency conversion rates that may affect the consistency of the generally accepted accounting principles that we use. The year ended December 31, 2004 includes five months of Larus Corporation activity. The year ended December 31, 2005 includes nine and one-half months of Pascall activity and four months of RO activity. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Overview."

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

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES AND THE OTHER FINANCIAL INFORMATION INCLUDED ELSEWHERE IN THIS REPORT. THIS REPORT AND THE FOLLOWING DISCUSSION CONTAIN FORWARD-LOOKING STATEMENTS REGARDING THE ELECTRONIC DEVICES AND COMMUNICATIONS EQUIPMENT INDUSTRIES AND OUR EXPECTATIONS REGARDING OUR FUTURE PERFORMANCE, LIQUIDITY AND CAPITAL RESOURCES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE EXPRESSED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF ANY NUMBER OF FACTORS, INCLUDING THOSE SET FORTH UNDER "RISK FACTORS" AND UNDER OTHER CAPTIONS CONTAINED ELSEWHERE IN THIS REPORT.

OVERVIEW

GENERAL

Through our three wholly-owned operating subsidiaries, EMRISE Electronics, CXR Larus and CXR-AJ, and through the divisions and subsidiaries of those subsidiaries, we design, develop, manufacture, assemble, and market products and services in the following two material business segments:

- Electronic Devices
  - electronic power supplies
  - digital and rotary switches
  - RF and microwave devices
- Communications Equipment
  - network access and transmission products
  - communication timing and synchronization products
  - communications test instruments

Sales to customers in the electronic devices segment, primarily to aerospace customers, defense contractors and industrial customers, were approximately 70.5%, 62.2% and 51.5% of our total net sales during 2006, 2005 and 2004, respectively. Sales of communications equipment and related services, primarily to private customer premises and public carrier customers, were approximately 29.5%, 37.8% and 48.5% of our total net sales during 2006, 2005 and 2004, respectively.

LARUS CORPORATION ACQUISITION

On July 13, 2004, we acquired Larus Corporation. Larus Corporation was a San Jose, California-based manufacturer and seller of telecommunications products that had one wholly-owned subsidiary, Vista Labs, Incorporated, or Vista, which provided engineering services to Larus Corporation. We paid $6,539,500 to acquire the outstanding common stock of Larus Corporation, which included a significant premium over the $1,800,000 recorded net worth of assets that included intellectual property, cash, accounts receivable and inventories owned by each of Larus Corporation and Vista. The purchase price for the acquisition consisted of $1,000,000 in cash, the issuance of 1,213,592 shares of our common stock with a fair value of $1,000,000, $887,500 in the form of two short-term, zero interest promissory notes that were repaid in 2004, $3,000,000 in the form of two subordinated secured promissory notes, warrants to purchase up to an aggregate of 150,000 shares of our common stock at $1.30 per share, which were valued at $72,526, and approximately $580,000 of acquisition costs. In addition, we assumed $245,000 in accounts payable and accrued expenses and entered into an above-market real property lease with the sellers. The lease represented an obligation that exceeded the fair market value by approximately $756,000 and is part of the acquisition accounting. The cash portion of the acquisition purchase price was funded with proceeds from our prior credit facility with Wells Fargo Bank, N.A. and cash on-hand.

PASCALL ACQUISITION

On March 18, 2005, our subsidiary, EEL, purchased all of the outstanding capital stock of PEHL, the parent holding company of Pascall, using funds loaned to EEL by EMRISE. The purchase price for the acquisition totaled $9,905,000, subject to adjustments as described in the purchase agreement, and included cash payments totaling $6,208,000 to Intelek Properties Limited (PEHL's former parent, which was a subsidiary of Intelek PLC, a London Stock Exchange public limited company), a $3,082,000 loan used by PEHL and Pascall to immediately repay intercompany debt owed to Intelek Properties Limited, and approximately $615,000 in acquisition costs.

We and Intelek PLC agreed to guarantee payment when due of all amounts payable by EEL and Intelek Properties Limited, respectively, under the purchase agreement. We and EEL agreed to underwrite the guaranty that Intelek Properties Limited has given to Pascall's landlord with a guaranty by us, and EEL has agreed to indemnify Intelek Properties Limited and its affiliates for damages they suffer as a result of any failure to obtain the release of the guarantee of the 17-year lease that commenced in May 1999. The leased property is a 30,000 square foot administration, engineering and manufacturing facility located off the south coast of England.

Intelek Properties Limited has agreed to various restrictive covenants that apply for various periods following the closing. The covenants include non-competition with Pascall's business, noninterference with Pascall's customers and suppliers, and non-solicitation of Pascall's employees. In conjunction with the closing, Intelek Properties Limited, Intelek PLC, EEL, and we entered into a Supplemental Agreement dated March 18, 2005. The Supplemental Agreement provides, among other things, that an interest-free bridge loan of 200,000 British pounds sterling (approximately $385,000 based on the exchange rate in effect on March 17, 2005) that was made by the seller to Pascall on March 17, 2005 and was repaid in full by Pascall on the March 31, 2005 due date.

The purchase price represented a significant premium over the recorded net worth of Pascall's assets. In conjunction with the acquisition of Pascall, the Company commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. The Company considered whether the acquisition included various types of identifiable intangible assets, including trade names, trademarks, patents, covenants not to compete, customers, workforce, technology and software. The Company has recorded the value of the trade name and trademark at $500,000, covenants not to compete that were obtained from Pascall's former affiliates at $200,000, amortizable over three years and backlog at $200,000 amortizable over two years.

RO ACQUISITION

On September 2, 2005, EMRISE Electronics acquired all of the issued and outstanding shares of common stock of RO under the terms of a stock purchase agreement dated effective as of August 31, 2005 and amended as of September 28, 2005. The purchase price consisted of $2,400,000 in cash paid at closing and an additional $600,000 in cash paid in two equal installments in October 2005 and October 2006, which amounts were partially offset by $35,000 received from the former RO shareholders to compensate for balance sheet adjustments.. The acquisition purchase price was funded with cash on-hand. In addition, concurrently with the closing of the acquisition of RO, EMRISE Electronics paid in full all then existing credit facilities of RO in the aggregate amount of $1,602,000.

In determining the purchase price for RO, EMRISE Electronics considered the historical and expected earnings and cash flow of RO, as well as the value of companies of a size and in an industry similar to RO, comparable transactions and the market for such companies generally. The purchase price represented a premium of approximately $2,275,000 over the $2,340,000 recorded net worth of the assets of RO. In determining this premium, EMRISE Electronics considered the synergistic and strategic advantages provided by having a United States-based power conversion manufacturer and the value of the goodwill, customer relationships and technology of RO. Goodwill associated with the RO acquisition totaled approximately $1,376,000. We commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. The valuation study of RO's intangibles was completed in June 2006. We initially estimated the intangibles to be valued as follows: technology, $484,000, trademarks, $300,000 and customer relationships, $200,000. The valuation study resulted in the following valuations: technology, $500,000, trademarks, $350,000 and customer relationships, $350,000. The intangibles were adjusted to the appraised values in the second quarter of 2006. The technology and customer relationships are being amortized over 10 years on their appraise values and the trademarks are not being amortized due to the inability to determine an estimated life.

In connection with the execution of the stock purchase agreement, EMRISE Electronics executed a lease agreement with Caspian Associates for the lease of 25,700 square feet of a 30,700 square feet building located at 246 Caspian Drive, Sunnyvale, California. The lease provided for a two-year term commencing on September 1, 2005 and ending on August 31, 2007, at a base rent of $9,210 per month. Additionally, the lease provided for an extension of the lease term for an additional three years, to August 31, 2010, and a rent increase if RO achieves certain net sales and cumulative gross profit targets. However, the targets were eliminated from the lease when the property was sold on November 1, 2006. Also, on March 1, 2007, the lease converted into a month-to-month tenancy where either party may provide the other with 30 days' notice to terminate the lease. We terminated the lease on March 31, 2007. Prior to termination, the lease obligation was $12,280 per month, which was more than the original $9,210 because a sublessee terminated its sublease in May 2006.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of those financial statements requires us 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 our critical accounting policies, defined as those policies that we believe are the most important to the portrayal of our financial condition and results of operations and that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

REVENUE RECOGNITION

We derive revenues from sales of electronic devices and communications

equipment products and services. Our sales are based upon written agreements or purchase orders that identify the type and quantity of the item being purchased and the purchase price. We recognize revenues when shipment of products has occurred or services have been rendered, no significant obligations remain on our part, and collectibility is reasonably assured based on our credit and collections practices and policies.

We recognize revenues from domestic sales of our electronic devices and communications equipment at the point of shipment of those products. Product returns are infrequent and require prior authorization because our sales are final and we quality test our products prior to shipment to ensure they meet the specifications of the binding purchase orders under which they are shipped. Normally, when a customer requests and receives authorization to return a product, the request is accompanied by a purchase order for a replacement product.

Revenue recognition for products and services provided by our United Kingdom subsidiaries 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 all revenue deferred until all services under the contracts have been completed. Production contracts provide for a specific quantity of products to be produced over a specific period of time. Customers issue binding purchase orders for each suborder to be produced. At the time each suborder is shipped to the customer, we recognize revenue relating to the products included in that suborder. 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. Generally, these products carry a one-year limited parts and labor warranty. We do not offer customer discounts, rebates or price protection on these products.

We recognize revenues for products sold by our French subsidiary 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. Generally, these products carry a two-year limited parts and labor warranty.

Generally, our electronic devices, network access and transmission products and communication timing and synchronization products carry a one-year limited parts and labor warranty and our communications test instruments and European network access and transmission products carry a two-year limited parts and labor warranty. Products returned under warranty are tested and repaired or replaced at our option. Historically, warranty repairs have not been material. We do not offer customer discounts, rebates or price protection on these products.

Revenues from services such as repairs and modifications are recognized when the service has been completed and invoiced. For repairs that involve shipment of a repaired product, we recognize repair revenues when the product is shipped back to the customer. Service revenues represented approximately 4.0%, 2.6% and 5.7% of net sales during 2006, 2005 and 2004, respectively.

INVENTORY VALUATION

Our finished goods electronic devices inventories generally are built to order. Our communications equipment inventories generally are built to forecast, which requires us to produce a larger amount of finished goods in our communications equipment business so that our customers can promptly be served. Our products consist of numerous electronic and other parts, which necessitates that we exercise detailed inventory management. We value our inventory at the lower of the actual cost to purchase or manufacture the inventory (first-in, first-out) or the current estimated market value of the inventory (net realizable value). We perform physical inventories at least once a year. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and production requirements for the next twelve months. Additionally, to determine inventory write-down provisions, we review product line inventory levels and individual items as necessary and periodically review assumptions about forecasted demand and market conditions. Any parts or finished goods that we determine are obsolete, either in connection with the physical count or at other times of observation, are reserved for and subsequently discarded and written-off.

In addition, the communications equipment industry is 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, our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventory. Although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventory and our reported operating results.

FOREIGN CURRENCY TRANSLATION

We have foreign subsidiaries that together accounted for approximately 63.5% of our net revenues, 56.4% of our assets and 56.9% of our total liabilities as of and for the year ended December 31, 2006. In preparing our consolidated financial statements, we are required to translate the financial statements of our foreign subsidiaries from the currencies in which they keep their accounting records into United States dollars. This process results in exchange gains and losses which, under relevant accounting guidance, are included either within our statement of operations or as a separate part of our net equity under the caption "accumulated other comprehensive income (loss)."

Under relevant accounting guidance, the treatment of these translation gains or losses depends upon our management's determination of the functional currency of each subsidiary. This determination involves consideration of relevant economic facts and circumstances affecting the subsidiary. Generally, the currency in which the subsidiary transacts a majority of its transactions, including billings, financing, payroll and other expenditures, would be considered the functional currency. However, management must also consider any dependency of the subsidiary upon the parent and the nature of the subsidiary's operations.

If management deems any subsidiary's functional currency to be its local currency, then any gain or loss associated with the translation of that subsidiary's financial statements is included as a separate component of stockholders' equity in accumulated other comprehensive income (loss). However, if management deems the functional currency to be United States dollars, then any gain or loss associated with the translation of these financial statements would be included within our statement of operations.

If we dispose of any of our subsidiaries, any cumulative translation gains or losses would be realized into our statement of operations. If we determine

that there has been a change in the functional currency of a subsidiary to United States dollars, then any translation gains or losses arising after the date of the change would be included within our statement of operations.

Based on our assessment of the factors discussed above, we consider the functional currency of each of our international subsidiaries as each subsidiary's local currency. Accordingly, we had cumulative translation gains of $698,000 and losses of $870,000 that were included as part of accumulated other comprehensive income (loss) within our balance sheets at December 31, 2006 and 2005, respectively. During the years ended December 31, 2006 and 2005, we included translation adjustment gains of approximately $1,568,000 and losses of approximately $1,357,000, respectively, under accumulated other comprehensive income (loss).

If we had determined that the functional currency of our subsidiaries was United States dollars, these gains or losses would have decreased or increased our gain or loss for 2006 and 2005. The magnitude of these gains or losses depends upon movements in the exchange rates of the foreign currencies in which we transact business as compared to the value of the United States dollar. These currencies include the euro, the British pound sterling and the Japanese yen. Any future translation gains or losses could be significantly higher or lower than those we recorded for these periods.

A $6,730,000 loan payable from EEL to EMRISE was outstanding as of December 31, 2006. The majority of this loan is expected to be outstanding indefinitely. Therefore, exchange rate losses and gains on this loan are recorded in cumulative translation gains or losses in the equity section of the balance sheet.

INTANGIBLES, INCLUDING GOODWILL

We periodically evaluate our intangibles, including goodwill, for potential impairment. Our judgments regarding the existence of impairment are based on legal factors, market conditions and operational performance of our acquired businesses.

In assessing potential impairment of goodwill, we consider these factors as well as forecasted financial performance of the acquired businesses. If forecasts are not met, we may have to record additional impairment charges not previously recognized. In assessing the recoverability of our goodwill and other intangibles, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of those respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets that were not previously recorded. If that were the case, we would have to record an expense in order to reduce the carrying value of our goodwill. On January 1, 2002, we adopted Statement of Financial Accounting Standards ("SFAS") No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS, and were required to analyze our goodwill for impairment issues by June 30, 2002, and then at least annually after that date or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. At December 31, 2006, the reported goodwill totaled $12,995,000. During 2006, we did not record any impairment losses related to goodwill and other intangible assets.

In conjunction with our July 2004 acquisition of Larus Corporation, we commissioned a valuation firm to determine what portion of the purchase price

should be allocated to identifiable intangible assets. The intangible values are as follows: Larus trade name and trademark are valued at $750,000, and the technology and customer relationships are valued at $1,350,000. Goodwill associated with the Larus Corporation acquisition totaled $4,043,000. The Larus trade name and trademark were determined to have indefinite lives and therefore are not being amortized but rather are being periodically tested for impairment. The technology and customer relationships were both estimated to have ten-year lives.

In conjunction with our March 2005 acquisition of Pascall, we commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. The Pascall trade name and trademark are valued at $500,000. The covenants not to compete that were obtained from Pascall's former affiliates are valued at $200,000. The backlog was valued at $200,000. Total amortization expense of $393,000 and $310,000 was charged to administrative expense in 2006 and 2005, respectively. The Pascall trade name and trademark were determined to have indefinite lives and therefore are not being amortized but rather are being periodically tested for impairment. The covenants not to compete and backlog are being amortized over their respective three-year and two-year durations. We estimated that the goodwill associated with the Pascall acquisition totaled $4,634,000.

In conjunction with our acquisition of RO, we commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. The valuation study of RO's intangibles was completed in June 2006. We initially estimated the intangibles to be valued as follows: technology, $484,000, trademarks, $300,000 and customer relationships, $200,000. The valuation study resulted in the following valuations: technology, $500,000, trademarks, $350,000 and customer relationships, $350,000. The intangibles were adjusted to the appraised values in the second quarter of 2006. The technology and customer relationships are being amortized over 10 years on their appraised values, and the trademarks are not being amortized due to the inability to determine an estimated life.

RESULTS OF OPERATIONS

The tables presented below, which compare our results of operations from one period to another, present the results for each period, the change in those results from one period to another in both dollars and percentage change, and the results for each period as a percentage of net sales. The columns present the following:

- The first two data columns in each table show the absolute results for each period presented.

- The columns entitled "Dollar Variance" and "Percentage Variance" show the change in results, both in dollars and percentages. These two columns show favorable changes as a positive and unfavorable changes as negative. For example, when our net sales increase from one period to the next, that change is shown as a positive number in both columns. Conversely, when expenses increase from one period to the next, that change is shown as a negative in both columns.

- The last two columns in each table show the results for each period as a percentage of net sales.

YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005

	YEAR ENDED DECEMBER 31, 2006	YEAR ENDED DECEMBER 31, 2005	DOLLAR VARIANCE FAVORABLE (UNFAVORABLE)	PERCENTAGE VARIANCE FAVORABLE (UNFAVORABLE)	RESU OF 2
			(DOLLARS IN THOUSANDS)		
Net sales					
Electronic devices	$ 32,702	$ 25,687	$ 7,015	27.3%	
Communications equipment	13,682	15,583	(1,901)	(12.2%)	
Total net sales	$ 46,384	$ 41,270	$ 5,114	12.4%	
Cost of sales					
Electronic devices	$ 20,955	$ 15,527	$ (5,428)	(35.0%)	
Communications equipment	8,458	8,187	(271)	(3.3%)	
Total cost of sales	$ 29,413	$ 23,714	$ (5,699)	(24.0%)	
Gross profit					
Electronic devices	$ 11,747	$ 10,160	$ 1,587	15.6%	
Communications equipment	5,224	7,396	(2,172)	(29.4%)	
Total gross profit	$ 16,971	$ 17,556	$ (585)	(3.3%)	
Selling, general and administrative expenses	$ 16,117	$ 13,707	$ (2,410)	(17.6%)	
Engineering and product development	3,085	2,621	(464)	(17.7%)	
Operating (loss) income	(2,231)	1,228	(3,459)	(281.7%)	
Interest expense	(490)	(455)	(35)	(7.7%)	
Interest income	89	153	(64)	(41.8%)	
Other income and expense, net	(364)	248	(612)	(246.8%)	
(Loss) income before income taxes	(2,996)	1,174	(4,170)	(355.2%)	
Income tax expense (benefit)	619	(267)	(886)	(331.8%)	
Net (loss) income	$ (3,615)	$ 1,441	$ (5,056)	(350.9%)	

NET SALES. The $5,114,000 (12.4%) increase in total net sales for 2006 as compared to 2005 resulted from the combination of a $7,015,000 (27.3%) increase in net sales of our electronic devices and a $1,901,000 (12.2%) decrease in net sales of our communications equipment products and services.

ELECTRONIC DEVICES. The increase in net sales within our electronic devices segment was primarily due to a $6,894,000 (48.8%) increase in sales of power supplies to $21,026,000 in 2006 from $14,132,000 in 2005. Contributing to

this increase was a $3,307,000 (240.5%) increase in RO's sales of power supplies due to inclusion of a full year of RO's sales in 2006 as compared to only four months of RO's sales included in 2005 because we acquired RO on August 31, 2005. Pascall increased its sales of power supplies by $1,853,000 (23.0%) to $9,927,000 in 2006. However, we acquired Pascall on March 18, 2005, so only nine and one-half months of sales for Pascall were included in our 2005 sales. The remainder of the $1,753,000 increase in sales of power supplies was due to an increase in sales volume for XPS. Sales of RF devices by Pascall increased by $614,000 (19.9%) to $3,697,000 in 2006 as compared to $3,083,000 in 2005 due to increased sales volume. Sales of switches were $6,580,000, which approximated sales of switches in the prior year. Sales of power supplies are expected to increase in 2007 due to our in-flight-entertainment contracts received or expected and our Eurofighter Typhoon aircraft contracts. We also expect future growth in sales for our new VLP(R) rotary switch.

COMMUNICATIONS EQUIPMENT. The majority of the decrease in sales within our communications equipment segment was due to a $1,446,000 (48.6%) decrease in sales of test equipment to $1,530,000 as compared to $2,976,000. This decrease was mainly due to a lower volume of sales caused by the erosion of the communications industry customer base for our test instruments due to our decision to not invest further in this product line, leaving us mainly selling to customers providing upgrades for a Federal Aviation Administration modernization project. Sales of our network access and transmission products decreased $561,000 (6.4%) to $8,269,000 in 2006 as compared to $8,830,000 in 2005. This decrease resulted from a $972,000 decrease in our CXR Larus U.S.-based sales primarily due to decreased sales volume due to competition, offset by a $411,000 increase in our CXR-AJ French-based sales due to increased sales volume. Partially offsetting these decreases was a modest increase in the sales of our timing systems by CXR Larus of $94,000 (3.6%) to $2,728,000. We expect that sales for CXR-AJ network access products will improve in 2007 while test instrument sales will remain at low levels or decline further. With the introduction of the new TiemPo(TM) 6400 communication timing and synchronization product from CXR Larus, we anticipate an improvement in sales of timing products in 2007.

GROSS PROFIT. Gross profit as a percentage of total net sales decreased to 36.6% from 42.5% for the prior year period due to a decrease in communications equipment sales. In dollar terms, gross profit decreased by $585,000 (3.3%) to $16,971,000 for 2006 as compared to $17,556,000 for 2005 due to a $2,172,000 reduction in gross profit within our communications equipment segment that more than offset a $1,587,000 increase in gross profit within our electronic devices segment.

ELECTRONIC DEVICES. The $1,587,000 (15.6%) increase in gross profit within this segment was primarily due to a $1,318,000 (32.6%) increase to $6,931,000 for our U.K. power supply operations. Of this increase, Pascall provided $868,000 due to an increase in sales volume and inclusion of a full year of operations in 2006, and XPS contributed $450,000 due to increased sales volume. Also contributing to the increase in gross profit was the addition of a full year of gross profit of $292,000 for RO. Gross profit for switches produced by Digitran remained constant at $2,901,000.

COMMUNICATIONS EQUIPMENT. The $2,172,000 reduction in gross profit within this segment was primarily due to a decrease of $1,151,000 in test equipment gross profit due to decreased sales volume. In addition, gross profit for our CXR Larus communication timing and network access products declined $926,000 due

to a $707,000 decrease in revenues due to a decrease in sales volume and a decrease in inventory carrying values for certain items deemed to be slow moving. The gross profit at our CXR-AJ French operation declined $107,000 due to a $463,000 decrease in revenues due to a decrease in sales volume and a change in accounting policy necessitating an increase in inventory write-off.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Our selling, general and administrative expenses increased in dollar terms and increased as a percentage of net sales to 34.7% in 2006 from 33.2% in 2005. The $2,410,000 (17.6%) increase in selling, general and administrative expenses for 2006 as compared to 2005 resulted from:

- $1,542,000 of administrative expenses related to the restatement of our 2005 and 2006 financial statements and the reaudit of our 2003, 2004 and 2005 financial statements. The restatement was necessary because sales of $224,000 were recorded in 2004 instead of appropriately being recorded in 2005. The $1,542,000 of administrative expenses included $1,282,000 of audit expense (as compared to $668,000 in 2005) and $261,000 of legal expense;

- an increase in administrative expenses primarily due to the increase and inclusion of $325,000 and $356,000 of administrative costs for Pascall and RO, respectively; and

- a $522,000 expense related to increasing employee compensation-related reserves.

We anticipate that selling, general and administrative expenses for 2007 will decrease from the level experienced in 2006 due the completion of our reaudit and restatement.

ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES. Engineering and product development expenses consist primarily of new product development engineering activities. The $464,000 (19.6%) increase in these expenses resulted primarily from the increase of $418,000 of expenses attributable to our decision to accelerate the introduction of TiemPo(TM) 6400, a new substantially improved timing system product, and a $243,000 increase in engineering expenses attributable to RO. The increase in engineering expense for the TiemPo(TM) 6400 was mainly due to $585,000 of contract engineering expenses we incurred in 2006 to accelerate product development of our new synchronization timing product. These increases were partially offset by a $177,000 reduction of engineering expenses for switches and power supplies. Overall engineering and product development expenses in 2007 are anticipated to be at level similar to the overall level in 2006.

INTEREST EXPENSE AND INCOME. The $35,000 increase in interest expense in 2006 was due to larger loan balances. We recorded $153,000 of interest income in 2005, which we earned on the proceeds of the January 2005 private placement.

OTHER INCOME AND EXPENSE, NET. Other expense in 2006 of $364,000 was primarily due to currency exchange loss. Other income of $248,000 in 2005 primarily resulted from a $100,000 gain due to the sale of our T-Com product line and a $123,000 net currency exchange gain. The T-Com technology and tangible assets had no carrying value.

INCOME TAX EXPENSE (BENEFIT). The $619,000 income tax expense in 2006

includes $474,000 of foreign taxes and $36,000 of state taxes. We recorded a $109,000 provision for federal tax in 2006 to reduce our deferred tax assets for federal purposes and to reduce the amount of operating loss carryforwards recognized. An income tax benefit of $267,000 was recorded in 2005 primarily because we reduced our tax asset valuation allowance by $555,000 and recorded a federal tax benefit of $150,000 that was offset by a foreign tax provision of $408,000 and a state tax provision of $30,000.

NET (LOSS) INCOME. Net loss for 2006 was $3,615,000 as compared to net income of $1,441,000 for 2005. Major contributors to this $5,056,000 difference were as follows:

- $1,542,000 of expenses related to the restatement and reaudit of our financial statements;

- a $2,172,000 lower gross profit of our communications equipment segment primarily due to decreased sales volumes;

- an $886,000 increase in tax provision primarily due to the $555,000 reduction in our tax asset valuation allowance in 2005 and increases in foreign and state taxes in 2006;

- a $612,000 decrease in other income and loss primarily due to currency exchange losses in 2006 as compared to a $123,000 net currency exchange gain in 2005; and

- a $522,000 expense related to increasing employee compensation-related reserves.

These negative amounts were partially offset with a $1,587,000 increase in gross profit for our electronic devices segment primarily due to a $7,015,000 increase in net sales in this segment.

YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004

	YEAR ENDED DECEMBER 31,		DOLLAR VARIANCE FAVORABLE	PERCENTAGE VARIANCE FAVORABLE	RESU OF
	2005	2004	(UNFAVORABLE)	(UNFAVORABLE)	2
	(DOLLARS IN THOUSANDS)				
Net sales					
Electronic devices..............	$ 25,687	$ 15,262	$ 10,425	68.3%	
Communications equipment.........	15,583	14,375	1,208	8.4%	
Total net sales....................	$ 41,270	$ 29,637	11,633	39.3%	
Cost of sales					
Electronic devices..............	$ 15,527	$ 9,024	(6,503)	(72.1)%	
Communications equipment.........	8,187	7,065	(1,122)	(15.9)%	

Total cost of sales	$ 23,714	$ 16,089	(7,625)	(47.4)%
Gross profit				
Electronic devices	$ 10,160	$ 6,238	3,922	62.9%
Communications equipment	7,396	7,310	86	1.2%
Total gross profit	$ 17,556	$ 13,548	4,008	29.6%
Selling, general and administrative expenses	$ 13,707	$ 10,212	(3,495)	34.2%
Engineering and product development	2,621	1,521	(1,100)	(72.3)%
Operating income	1,228	1,815	(587)	(32.3)%
Interest expense	(455)	(433)	(22)	(5.1)%
Interest income	153	--	153	--
Other income (expense), net	248	(6)	254	4,233.3%
Income before income taxes	1,174	1,376	(202)	(14.7)%
Income tax (benefit) expense	(267)	49	316	644.9%
Net income	$ 1,441	$ 1,327	$ 114	8.6%

NET SALES. The $11,633,000 (39.3%) increase in total net sales for 2005 as compared to 2004 resulted from the combination of a $10,425,000 (68.3%) increase in net sales of our electronic devices and a $1,208,000 (8.4%) increase in net sales of our communications equipment products and services.

ELECTRONIC DEVICES. The increase in net sales within our electronic devices segment resulted primarily from the inclusion in our 2005 results of Pascall's $11,157,000 sales of power supplies and RF devices and RO's $1,925,000 sales of power conversion products and licensing. This increase occurred despite a $2,939,000 (32.0%) decrease in sales at XPS primarily related to reduced sales of power supplies due to the delay of deliveries for the Eurofighter Typhoon aircraft. Sales of switches manufactured by Digitran increased $1,021,000 (18.5%) to $6,545,000 for 2005 from $5,524,000 for the prior year period due to sales of new rotary switches and other new programs for our digital switches.

We first reported sales of RF devices during the three months ended March 31, 2005 as a result of our acquisition of Pascall. We acquired RO on August 31, 2005. If we excluded sales by Pascall from March 18, 2005 through December 31, 2005 and sales by RO for September 1, 2005 through December 31, 2005, our electronic devices segment sales would have declined by $2,657,000 or (17.4%) for 2005.

COMMUNICATIONS EQUIPMENT. The $1,208,000 increase in net sales within our communications equipment segment resulted primarily from the inclusion in our 2005 results of the full year of $5,974,000 of net sales of communication timing and synchronization products attributable to our acquisition of Larus Corporation that occurred on July 13, 2004 as compared to sales of $3,424,000 for the period from July 13, 2004 to December 31, 2004. This increase occurred despite a $869,000 (24.6%) decline in net sales of test instruments primarily due to delays and reductions in expected orders from large carriers. Sales of network access equipment produced by CXR-AJ decreased by $380,000 (6.2%) to

$5,759,000 in 2005 as compared to $6,139,000 in 2004 due to lower sales volume in military markets.

GROSS PROFIT. Gross profit as a percentage of total net sales decreased to 42.5% from 45.7% for the prior year period due to a lower gross margin for our communications equipment segment. In dollar terms, gross profit increased by $4,008,000 (29.6%) to $17,556,000 for 2005 as compared to $13,548,000 for 2004 primarily as a result of the addition of gross profit from Pascall and RO.

ELECTRONIC DEVICES. The $3,922,000 (62.9%) increase in gross profit for our electronic devices segment was primarily due to the inclusion in our results for 2005 of $3,484,000 of gross profit from Pascall and $788,000 of gross profit from RO. Partially offsetting these increases was a $244,000 reduction in gross profit from switches primarily due to product mix and a $399,000 decrease in gross profit on power supplies produced by XPS as a direct result of reduced sales volume due to contract delivery delays for the Eurofighter Typhoon aircraft. XCEL Japan Ltd. increased its gross profit by $346,000 (62.0%) to $904,000 from $558,000 in the prior year due to increased sales of higher margin military switches.

COMMUNICATIONS EQUIPMENT. This segment had a slight $86,000 decrease in gross profit. CXR Larus contributed $2,755,000 of gross profit for 2005 relating to net sales of network access and communication timing and synchronization products as compared to $1,782,000 for the period from July 13, 2004 to December 31, 2004. Gross profit for test instruments decreased $805,000 (30.4%) to $1,845,000 in 2005 as compared to $2,650,000 in 2004 due to lower volume. Due to reduced overhead costs, CXR-AJ recorded a relatively low $84,000 decrease in gross profit despite a $359,000 decline in sales, resulting in a gross margin for CXR-AJ of 42.0% in 2005 as compared to a gross margin for CXR-AJ of 41.0% in 2004.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Our selling, general and administrative expenses increased in dollar terms but decreased as a percentage of net sales to 33.2% in 2005 from 34.5% in 2004. The $3,495,000 (34.2%) increase in selling, general and administrative expenses for 2005 as compared to 2004 resulted from:

- a $359,000 (54.8%) increase in sales commissions due to the increase or inclusion of $85,000, $243,000 and $73,000 of sales commission expenses of CXR Larus, Pascall and RO, respectively, partially offset by reductions in commission expenses of $22,000 for test instruments and $22,000 for our French-produced network access products;

- a $1,505,000 (48.5%) increase in other selling and marketing expenses primarily due to an increase of $694,000 and the inclusion of $924,000 and $71,000 of selling expenses of our Larus division, Pascall and RO, respectively, attendance at tradeshows and increased advertising and marketing of our electronic devices. These increases were partially offset by decreases in these expenses of $71,000 for test instruments and $118,000 at CXR-AJ;

- a $1,622,000 (25.1%) increase in administrative expenses primarily due to the increase or inclusion of $337,000 and $775,000 of administrative costs for our Larus division and Pascall, respectively;

- $74,000 in severance costs we recorded to administrative expense to reflect a consolidation of CXR Larus' operations;

- a $55,000 expense we recorded for a repair provision for the building in Wales that we vacated to combine our coil winding business with XPS's operations in Ashford, England; and

- a $144,000 increase in our domestic legal expenses and a $282,000 increase in our domestic accounting and auditing expenses plus an increase of $227,000 in consulting fees relating to internal control documentation in response to the Sarbanes-Oxley Act of 2002.

ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES. Engineering and product development expenses consist primarily of new product development engineering activities. The $1,100,000 (72.3%) increase in these expenses resulted primarily from the increase of $443,000 of expenses attributable to our Larus division and a $513,000 increase in engineering expenses attributable to Pascall. Also, expenses related to development of our new low profile rotary switches increased $58,000 (12.0%) to $540,000 for 2005 as compared to $482,000 for 2004. During 2005, we eliminated one of our two engineering directors at CXR Larus, which is helping to offset approximately $75,000 of our increased engineering expenses on an annual basis.

INTEREST EXPENSE AND INCOME. Interest expense increased by $22,000 (5.1%) to $455,000 for 2005 as compared to $433,000 for 2004. In addition, we recorded $153,000 of interest income in 2005, which we earned on the proceeds of the January 5, 2005 private placement. We did not have interest income during 2004.

OTHER INCOME AND EXPENSE, NET. Other income of $248,000 for 2005 primarily resulted from a $100,000 gain due to the sale of our T-Com product line and $123,000 of a net currency exchange gain. The T-Com technology and tangible assets had no carrying value.

INCOME TAX (BENEFIT) EXPENSE. Income tax benefit for 2005 was $267,000, compared to an expense of $49,000 for 2004 primarily because we reduced our tax asset valuation allowance by $555,000 and recorded a federal tax benefit of $150,000 that was offset by our foreign tax provision of $408,000 and a state tax provision of $30,000.

NET INCOME. Net income for 2005 increased by $114,000 to $1,441,000 as compared to $1,327,000 for 2004. The increase was primarily due to an increase in gross profit in our electronic devices segment resulting from our acquisitions of Pascall and RO. We continue to closely monitor costs throughout our operations and have reduced costs through staffing reductions in our communications equipment operations in the United States and France as indicated above.

LIQUIDITY AND CAPITAL RESOURCES

During 2006, we funded our operations primarily through revenue generated from our operations and through our previous line of credit with Wells Fargo Bank, N.A. ("Bank credit facility"), a new credit facility ("WFBC credit facility") with Wells Fargo Bank acting through its Wells Fargo Business Credit operating division ("WFBC"), and facilities with various foreign banks. As of December 31, 2006, we had working capital of $9,611,000, which represented a $3,347,000 (25.8%) decrease from working capital of $12,958,000 at December 31, 2005, primarily due to the $1,542,000 of expenses we incurred in 2006 related to the restatement and reaudit of our financial statements and increased accrued expenses. At December 31, 2006 and 2005, we had accumulated deficits of $18,733,000 and $15,118,000, respectively, and cash and cash equivalents of $3,802,000 and $4,371,000, respectively.

Accounts receivable decreased $193,000 (2.1%) during 2006, from $9,413,000 as of December 31, 2005 to $9,220,000 as of December 31, 2006. Days sales outstanding, which is a measure of our average accounts receivable collection period, decreased from 67 days for 2005 to 63 days for 2006. Our customers include many Fortune 100 companies in the United States and similarly large companies in Europe and Asia. Because of the financial strength of our customer base, we incur few bad debts.

Inventory balances increased $298,000 (2.9%) during 2006, from $10,277,000 at December 31, 2005 to $10,575,000 at December 31, 2006. Inventory represented 23.6% and 23.1% of our total assets as of December 31, 2006 and December 31, 2005, respectively. Inventory turnover, which is a ratio that indicates how many times our inventory is sold and replaced over a specified period, was 2.8 times for 2006 as well as for 2005.

We took various actions to reduce costs in 2004 and 2005. These actions were intended to reduce the cash outlays of our communications equipment segment to match its revenue rate, which was negatively impacted by the telecommunications downturn of 2002 and 2003. We merged Larus Corporation with and into CXR Telcom Corporation at the end of 2004 and integrated their operations. In 2005, we contracted with a contract manufacturer, Hitachi, for production of communication timing and synchronization products at lower prices than our previous cost for in-house manufacturing for production that began in the second quarter of 2006.

Cash used in our operating activities totaled $1,113,000 for 2006 as compared to cash provided by operating activities of $1,140,000 for 2005. This $2,253,000 decrease in operating cash flows primarily resulted from the $3,615,000 net loss and a $579,000 increase in inventory that were partially offset by depreciation, amortization and accrued expenses.

Cash used in our investing activities totaled $785,000 for 2006 as compared to $15,044,000 for 2005. The 2006 amount consists of net increases to property, plant and equipment. Included in the results for 2005 are net cash amounts of $10,154,000 and $4,623,000 used to acquire Pascall and RO, respectively. Also in 2005, we acquired $287,000 of property, plant and equipment purchases for production equipment and computer equipment. We have guaranteed obligations of EMRISE Electronics in connection with the Pascall acquisition and have agreed to indemnify Pascall's former parent in connection with obligations under Pascall's facilities lease.

Cash provided by our financing activities totaled $391,000 for 2006 as compared to $18,050,000 for 2005. The change is primarily due to the net proceeds in 2005 of $16,060,000 from the issuance of common stock in our January 2005 private placement of 12,503,500 shares of common stock at a purchase price of $1.44 per share and five-year investor warrants to purchase up to an additional 3,125,875 shares of our common stock at an exercise price of $1.73 per share. We paid cash placement agent fees and expenses of approximately $961,000, and issued five-year placement warrants to purchase up to an aggregate of 650,310 shares of common stock at an exercise price of $1.73 per share in connection with the offering.

At December 31, 2005, we had $3,283,000 of outstanding borrowings under lines of credit with foreign banks. At December 31, 2006, outstanding borrowings and availability under our revolving lines of credit were as follows:

	Maximum Contractual Availability	Outstanding Borrowings	Actual Remainin Availabil
Line of credit with a U.S. commercial lender	$ 2,080,000	$ 1,978,000	$ 102
Lines of credit with foreign banks	5,687,000	2,332,000	3,355
	$ 7,767,000	$ 4,310,000	$ 3,457

Actual remaining availability represents the additional amount we were eligible to borrow as of December 31, 2006. Maximum contractual availability represents the maximum amount of availability provided under the contract as of that date and includes the actual remaining availability.

In addition to the revolving lines of credit, at December 31, 2006, we had long-term loans and capitalized lease and equipment loan obligations totaling $1,049,000, the current portion of which loans and obligations totaled $516,000. At December 31, 2005, our long-term loans and capitalized lease and equipment loan obligation totaled $1,246,000, the current portion of which loans and obligation totaled $504,000.

Below are descriptions of key terms of our various domestic and foreign credit facilities and debt obligations.

On August 25, 2005, we and two of our subsidiaries, CXR Larus and EMRISE Electronics, acting as guarantors, obtained the Bank credit facility for our United States operations. The Bank credit facility provided a $9,000,000 revolving line of credit secured by accounts receivable, other rights to payment and general intangibles, inventories and equipment, with an interest rate adjusted monthly based on the prime rate.

The Bank credit facility also provided for a term loan of $150,000 secured by equipment, amortizable over 36 months at a variable rate equal to the prime rate plus 1.5%. In addition, Wells Fargo Bank provided us with credit for the purchase of new capital equipment when needed, with an interest rate equal to the 90-day London InterBank Offered Rate ("LIBOR") (5.36% at December 31, 2006) plus 3.75% per annum. Amounts borrowed under this arrangement are being amortized over 60 months from the respective dates of borrowing and secured by the purchased equipment.

We and Wells Fargo Bank amended the credit facility in November 2005 and March 2006 to revise various covenants and other provisions. On September 19, 2006, we entered into a Third Amendment to Credit Agreement effective as of September 1, 2006 with Wells Fargo Bank. The amendment provided for the waiver by Wells Fargo Bank of certain violations of financial covenants. The amendment also provided for the reduction in the amount of the Bank credit facility from $9,000,000 to $1,500,000 and limited borrowings to 80% of eligible accounts receivable. In connection with the amendment, we executed a Revolving Line of Credit Note dated September 1, 2006 in the amount of $1,500,000. On October 9, 2006, we executed a letter agreement dated effective October 1, 2006 with Wells

Fargo Bank extending the maturity date of the $1,500,000 note to October 20, 2006.

On November 13, 2006, Wells Fargo Bank issued a notice of default and demand for payoff with respect to the $1,500,000 note. All obligations under the note were due and payable on November 20, 2006. On November 24, 2006, we entered into a Forbearance Agreement with Wells Fargo Bank, dated effective as of November 20, 2006, whereby Wells Fargo Bank agreed to forbear from exercising its rights under the Bank credit facility as described in the notice of default and demand for payoff through December 1, 2006. On December 1, 2006, EMRISE Corporation, EMRISE Electronics, CXR Larus, RO and WFBC entered into a Credit and Security Agreement ("WFBC credit facility") providing for a revolving line of credit and term loan. On December 5, 2006, we paid off the $1,500,000 Bank credit facility in full.

The WFBC credit facility provides for a $5,000,000 revolving line of credit that expires on December 1, 2009 and is secured by accounts receivable, other rights to payment and general intangibles, inventories and equipment. The line of credit is formula-based and generally provides that the outstanding borrowings under the line of credit may not exceed an aggregate of 85% of eligible accounts receivable plus 10% of the value of eligible finished goods inventory. Interest is payable monthly. The interest rate is variable and is adjusted monthly based on the prime rate plus 1%. The prime rate at December 1, 2006 was 8.25%.

The WFBC credit facility is subject to an unused line fee equal to 0.25% per annum, payable monthly based on the average daily unused amount of the line of credit. The WFBC credit facility is also subject to a minimum monthly interest charge of $8,500 with respect to the revolving line of credit.

The WFBC credit facility is subject to various financial covenants on a consolidated basis as follows. The minimum debt service coverage ratio must be greater than 1.20:1.00 on a trailing quarterly basis. "Debt service coverage ratio" is defined as net income after taxes, plus depreciation, plus amortization, plus or minus changes in deferred taxes, minus capital expenditures and minus any dividends or distributions, divided by the current maturities of long-term debt paid or scheduled to be paid plus any payments on subordinated debt. The WFBC credit facility also requires that we maintain a minimum book net worth, determined at the end of each calendar month, in an amount not less than $26,900,000 for the months ended December 31, 2006, January 31, 2007 and February 28, 2007 and of not less than that amount plus 80% of our net income for each calendar quarter ending on or after March 31, 2007 and for each calendar month ending on or after March 31, 2007. We were not permitted to incur a net loss of greater than $1,150,000 for 2006, and for each quarterly period occurring after December 31, 2006, our net income must not be less than $0.

If WFBC terminates the WFBC credit facility during a default period, or if we terminate or reduce the WFBC credit facility prior to the maturity date, or if we prepay the term loan portion of the facility, we will be subject to penalties as follows: if the termination or prepayment occurs during the one year period after the initial funding date, the penalty is equal to 3% of the maximum line amount and/or prepayment amount; if the termination or prepayment occurs during second year after the initial funding date, the penalty is equal to 2% of the maximum line amount and/or prepayment amount; and if the termination or prepayment occurs at any time after the second anniversary of the

initial funding date and prior to the maturity date, the penalty is equal to 1% of the maximum line amount and/or prepayment amount.

In the event of a default and continuation of a default, Wells Fargo may accelerate the payment of the principal balance, requiring us to pay the entire indebtedness outstanding on that date. From and after the maturity date of the WFBC credit facility, or any earlier date that all principal owing under the WFBC credit facility becomes due and payable by acceleration or otherwise, the outstanding principal balance will bear interest until paid in full at an increased rate per annum equal to 3% above the rate of interest in effect from time to time under the WFBC credit facility.

The WFBC credit facility also provides for a term loan of $200,000 secured by accounts receivable, other rights to payment, and general intangibles, inventories and equipment, amortizable over 36 months at a variable rate equal to the prime rate plus 1%.

As of December 31, 2006, we had balances of $1,978,000 outstanding on the revolving line of credit and $200,000 outstanding on the term loan. Availability on the WFBC revolving line of credit was $102,000. As of December 31, 2006, we were not in compliance with the loan's financial covenants for net worth and net losses. However, we have obtained a waiver from WFBC for those covenant violations. WFBC is modifying the financial covenants for 2007.

As of December 31, 2006, our foreign subsidiaries had credit facilities, including lines of credit and term loans, with Lloyds TSB Bank PLC ("Lloyds TSB") and Lloyds TSB Commercial Finance Limited ("Lloyds") in England, IFN Finance, a subsidiary of ABN AMRO Holdings, N.V., Banc National de Paris, Societe Generale in France, and Sogelease and Johnan Shinkin Bank in Japan. At December 31, 2006, the balances outstanding under our United Kingdom, France and Japan credit facilities were $1,762,000, $1,156,000 and $15,000, respectively.

On July 8, 2005, XPS and Pascall obtained a credit facility with Lloyds. At the same time, the credit facility of Venture Finance PLC, a subsidiary of ABN AMRO Holdings, N.V., was terminated, and all debt to Venture Finance PLC was paid off. The Lloyds facility provides a revolving loan secured by receivables, with a maximum availability of 2,100,000 British pounds sterling (approximately $4,114,000 based on the exchange rate in effect on December 31, 2006). The annual interest rate on the revolving loan is 1.5% above the Lloyds TSB base rate. The Lloyds TSB base rate was 5.0% at December 31, 2006. The financial covenants include a 50% cap on combined export gross sales of XPS and Pascall and days sales outstanding of less than 65 days, and the funding balance is capped at 125% of XPS and Pascall combined gross sales. Based on our long-term relationship with Lloyds Bank, we anticipate but can give no assurance that we will be able to renew or obtain a new credit facility from Lloyds Bank when this existing facility expires July 31, 2007.

On August 26, 2005, XPS entered into an agreement with Lloyds for an unsecured cashflow loan of 300,000 British pounds sterling (approximately $587,000 based on the exchange rate in effect on December 31, 2006), payable over 12 months. The loan is structured as an overadvance on the previously negotiated 2,100,000 British pounds sterling revolving loan with Lloyds, bringing the maximum aggregate commitment on the revolving loan to 2,400,000 British pounds sterling (approximately $4,700,000 based on the exchange rate in effect on December 31, 2006). The interest rate is variable and is adjusted monthly based on the base rate of Lloyds TSB plus 1.9%. Lloyds TSB has sole

discretion to switch the details on this overadvance account if Lloyds determines that we will have difficulty in meeting the specific reductions in the overadvance account. The balance on the XPS and Pascall revolving loans at December 31, 2006 was $1,204,000. Availability on the XPS and Pascall revolving loans was $3,015,000 as of December 31, 2006.

On August 26, 2005, EEL, a United Kingdom-based subsidiary of ours, entered into an agreement with Lloyds TSB for an unsecured term loan of 500,000 British pounds sterling (approximately $979,000 based on the exchange rate in effect on December 31, 2006). This loan is repayable in 36 consecutive monthly installments, representing principal and interest. The interest rate is variable and is adjusted daily based on the Lloyds TSB base rate plus 2.5%. The loan also includes financial covenants. EEL must maintain profit before taxation and interest paid and payable of no less than 150% of interest paid and payable.

In the event of a default, Lloyds may make the loans, including any outstanding principal and interest that has accrued, repayable on demand. If any amount payable is not paid when due, EEL must pay an increased interest rate per annum equal to 3% above the rate of interest in effect from time to time under the note.

In April 2003, CXR-AJ obtained a credit facility from IFN Finance, a subsidiary of ABN AMRO N.V. This credit facility is for a maximum of $1,583,000 based on the exchange rate in effect at December 31, 2006 for the conversion of euros into United States dollars. CXR-AJ also had $28,000 of term loans with another French bank outstanding as of December 31, 2006. The IFN Finance facility is secured by accounts receivable and carries an annual interest rate of 1.6% above the French "T4M" rate. At December 31, 2006, the French T4M rate was 3.52%, and this facility had a balance of $1,128,000. This facility has no financial performance covenants. Availability on the IFN Finance credit line was $188,000 as of December 31, 2006, in addition to $152,000 availability with several other banks.

XCEL Japan Ltd., or XJL, obtained a term loan on November 29, 2002 from Johnan Shinkin Bank. The loan is amortized over five years, carries an annual fixed interest rate of 3.25% and is secured by the assets of XJL. The balances of the loan as of December 31, 2006 and 2005 were $15,000 and $32,000, respectively, using the exchange rates in effect at those dates for conversion of Japanese yen into United States dollars. There are no financial performance covenants applicable to this loan.

Our backlog was $25,784,000 as of December 31, 2006 as compared to $22,150,000 as of December 31, 2005. The increase in backlog was primarily due to an increase of $3,282,000 in power supply backlog at our U.K. subsidiaries, XPS and Pascall. In addition, CXR-AJ increased its backlog of network access products by $449,000. Our backlog as of December 31, 2006 was approximately 96% related to our electronic devices business, which business tends to provide us with long lead-times for our manufacturing processes due to the custom nature of the products, and approximately 4% related to our communications equipment business, which business tends to deliver standard products from stock as orders are received. 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 with respect to which work is currently in progress. 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.

The following table outlines payments due from us or our subsidiaries under our lines of credit and other significant contractual obligations over the next five years, exclusive of interest. All dollars are in thousands. The symbol "P" represents the prime rate, the symbol "B" represents the lender's base rate and the symbol "L" represents the 30-day LIBOR.

CONTRACTUAL OBLIGATIONS AT DECEMBER 31, 2006	PAYMENTS DUE BY PERIOD (IN THOUSANDS) 2007	2008	2009	2010	2011	T A
Line of Credit (Domestic)	$ 1,978	$ --	$ --	$ --	$ --	$
Average Interest Rate	P+0.5%					
Line of Credit (U.K.)...	$ 1,204	$ --	$ --	$ --	$ --	$
Average Interest Rate	B+2%					
Overdraft (France)......	$ 1,128	$ --	$ --	$ --	$ --	$
Average Interest Rate	%					
Term Loan From Stockholders (Domestic).	$ 500	$ 500	$ 500	$ 250	$	$
Average Interest Rate	P+1.5%, L+5.0%					
Capital Equipment Loan (U.S.)..............	$ 25	$ 36	$ 36	$ --	$	$
Average Interest Rate	L+4%					
Term Loans (U.S.).......	$ 67	$ 67	$ 66	$ --	$ --	$
Average Interest Rate	P+1.5%					
Term Loan (U.K.)........	$ 331	$ 227	$ --	$ --	$ --	$
Average Interest Rate	B+2%					
Term Loans (France).....	$ 11	$ 17	$ 5	$ --	$ --	$
Average Interest Rate	1.2%-5.6%					
Term Loan (Japan).......	$ 15	$ --	$ --	$ --	$ --	$
Average Interest Rate	3.25%					
Capitalized Lease Obligations...........	$ 69	$ 41	$ 20	$ 14	$ 7	$
Operating Leases........	$ 1,016	$ 877	$ 623	$ 264	$ 9	$
	$ 6,344	$ 1,775	$ 1,245	$ 528	$ 16	$

We intend to grow our business through both internal growth and further acquisitions that we identify as being potentially both synergistic and accretive of our earnings. Any additional acquisitions would likely be funded through the use of cash and/or a combination of cash and notes.

We believe that current and future available capital resources, revenues generated from operations, and other existing sources of liquidity, including the credit facility we have with WFBC, will be adequate to meet our anticipated working capital and capital expenditure requirements for at least the next twelve months. If, however, we are unable to renew or replace the XPS and Pascall credit facility with Lloyds Bank that expires July 31, 2007, or if our capital requirements or cash flow vary materially from our current projections

or other unforeseen circumstances occur, or if we require a significant amount of cash to fund future acquisitions, we may require additional financing. Our failure to raise capital, if needed, could restrict our growth, limit our development of new products or hinder our ability to compete.

EFFECTS OF INFLATION

The impact of inflation and changing prices has not been significant on the financial condition or results of operations of either our company or our operating subsidiaries.

IMPACTS OF NEW ACCOUNTING PRONOUNCEMENTS

On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004), SHARE-BASED PAYMENT, which is a revision of SFAS No. 123. SFAS No. 123R superseded Accounting Principles Board ("APB") Opinion No. 25, and amended SFAS No. 95, STATEMENT OF CASH FLOWS. Generally, the approach in SFAS No. 123R is similar to the approach described in SFAS 123. However, SFAS 123R generally requires share-based payments to employees, including grants of employee stock options and purchases under employee stock purchase plans, to be recognized in the statement of operations based on their fair values. Pro forma disclosure of fair value recognition is no longer an alternative. We adopted this new standard on January 1, 2006 using the modified prospective method under which compensation cost is recognized beginning with the effective date of adoption (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date of adoption and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of adoption that remain unvested on the date of adoption.

SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under earlier accounting rules. This requirement reduces net operating cash flows and increases net financing cash flows in periods after adoption. Total cash flow remains unchanged from what would have been reported under prior accounting rules. In 2006, we recorded expenses of $131,000 relating to currently outstanding stock options. We estimate that in 2007 we will record $30,000 of additional expenses relating to currently outstanding stock options.

The actual effects of adopting SFAS No. 123R will depend on numerous factors, including the amounts of share-based payments granted in the future, the valuation model we use to value future share-based payments to employees and estimated forfeiture rates.

In November 2004, the FASB issued SFAS No. 151, INVENTORY COSTS, AN AMENDMENT OF ARB NO. 43, CHAPTER 4. SFAS No. 151 clarifies that abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage) are required to be recognized as current period costs. The provisions of SFAS No. 151 became effective for 2006. Adoption did not have a material effect on our financial position, results of operations or cash flows.

On December 16, 2004, the FASB issued SFAS No. 153, EXCHANGES OF NONMONETARY ASSETS, AN AMENDMENT OF APB OPINION NO. 29, ACCOUNTING FOR NONMONETARY TRANSACTIONS. SFAS No. 153 addresses the measurement of exchanges of

nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 became effective for nonmonetary asset exchanges beginning in the second quarter of 2006. Our adoption of SFAS No. 153 has not had a material effect on our consolidated financial position, results of operations or cash flows.

On June 7, 2005, the FASB issued SFAS No. 154, ACCOUNTING CHANGES AND ERROR CORRECTIONS, A REPLACEMENT OF APB OPINION NO. 20, ACCOUNTING CHANGES, and SFAS No. 3, REPORTING ACCOUNTING CHANGES IN INTERIM FINANCIAL STATEMENTS. SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition of a cumulative effect adjustment within net income of the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 became effective for accounting changes made in fiscal years beginning after December 15, 2005. However, SFAS No. 154 does not change the transition provisions of any existing accounting pronouncements. Our adoption of SFAS No. 154 has not had a material effect on our consolidated financial position, results of operations or cash flows.

In February 2006, the FASB issued SFAS No. 155, ACCOUNTING FOR CERTAIN HYBRID FINANCIAL INSTRUMENTS, which amends SFAS No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES and SFAS No. 140, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS. Specifically, SFAS No. 155 amends SFAS No. 133 to permit fair value remeasurement for any hybrid financial instrument with an embedded derivative that otherwise would require bifurcation, provided the whole instrument is accounted for on a fair value basis. Additionally, SFAS No. 155 amends SFAS No. 140 to allow a qualifying special purpose entity to hold a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 applies to all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006, with early application allowed. We do not expect that the adoption of SFAS No. 155 will have a material effect on our results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, FAIR VALUE MEASUREMENTS. This new statement provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS No. 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. The required effective date of SFAS No. 157 is the first quarter of 2008. We currently are evaluating the effect this statement may have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES. SFAS No. 159 permits an entity to irrevocably elect fair value on a contract-by-contract basis as the initial and subsequent measurement attribute for many financial assets and liabilities and certain other items including insurance contracts. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense up front cost and fees associated with the item for which the fair value option is elected. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided

the entity also elects to apply the provisions of SFAS No. 157, FAIR VALUE MEASUREMENTS. We currently are evaluating the effect that adoption of SFAS No. 159 would have on our financial condition or results of operations.

In June 2006, the FASB issued Financial Interpretation No. 48, ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES--AN INTERPRETATION OF FASB STATEMENT NO. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. The interpretation also provides guidance on derecognition, classification, interest and penalties, and other matters. These provisions are effective for us beginning in the first quarter of 2007. We currently are assessing the effect of this statement and currently do not believe that adoption will have a material effect on our consolidated financial statements.

On June 29, 2005, the FASB ratified Emerging Issues Task Force ("EITF") Issue No. 05-06, DETERMINING THE AMORTIZATION PERIOD FOR LEASEHOLD IMPROVEMENTS. Issue No. 05-06 provides that the amortization period used for leasehold improvements acquired in a business combination or purchased after the inception of a lease shall be the shorter of (a) the useful life of the assets or (b) a term that includes required lease periods and renewals that are reasonably assured upon the acquisition or the purchase. The provisions of EITF Issue No. 05-06 became effective on a prospective basis for leasehold improvements purchased or acquired beginning in the second quarter of 2006. The adoption of EITF Issue No. 05-06 has not had a material effect on our consolidated financial position, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission ("Commission") issued Staff Accounting Bulletin ("SAB") No. 108, Topic 1N, FINANCIAL STATEMENTS - CONSIDERING THE EFFECTS OF PRIOR YEAR MISSTATEMENTS WHEN QUANTIFYING MISSTATEMENTS IN THE CURRENT YEAR FINANCIAL STATEMENTS. SAB No. 108 addresses how to quantify the effect of an error on the financial statements and requires a dual approach to compute the materiality of the misstatement. Specifically, the amount of the misstatement is to be computed using both the "rollover" (that is, the current year income statement perspective) and the "iron curtain" (that is, the year-end balance sheet perspective). SAB No. 108 is effective for all fiscal years ending after November 15, 2006. Accordingly, we adopted SAB No. 108 in the fourth quarter of 2006. The adoption of SAB No. 108 did not have a material effect on our financial condition or results of operations.

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

EXCHANGE RATE SENSITIVITY

We have established and acquired international subsidiaries that prepare their balance sheets in the relevant foreign currency. In order to be included in our consolidated financial statements, these balance sheets are converted, at the then current exchange rate, into United States dollars, and the statements of operations are converted using weighted average exchange rates for the

applicable period. Accordingly, fluctuations of the foreign currencies relative to the United States dollar affect our consolidated financial statements. Our exposure to fluctuations in currency exchange rates has increased as a result of the growth or acquisition of our international subsidiaries. However, because historically the majority of our currency exposure has related to financial statement translation rather than to particular transactions, prior to 2005 we had not entered into forward currency contracts or hedging arrangements in an effort to mitigate our currency exposure. For further information regarding our exchange rate sensitivity, see Item 7 of this report under the heading "Critical Accounting Policies - Foreign Currency Translation."

INTEREST RATE SENSITIVITY

A substantial portion of our notes payable and long-term debt have variable interest rates based on the prime interest rate and/or the lender's base rate, which exposes us to risk of earnings loss due to changes in such interest rates.

We have established and acquired international subsidiaries that prepare their balance sheets in the relevant foreign currency. In order to be included in our consolidated financial statements, these balance sheets are converted, at the then current exchange rate, into United States dollars, and the statements of operations are converted using weighted average exchange rates for the applicable period. Accordingly, fluctuations of the foreign currencies relative to the United States dollar could have an effect on our consolidated financial statements. Our exposure to fluctuations in currency exchange rates has increased as a result of the acquisition of Pascall located in England.

SFAS No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES, as amended, establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or a liability measured at its fair value. SFAS No. 133 also requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met, and that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting. We currently use derivatives to manage foreign currency rate risk.

One of our United Kingdom subsidiaries that conducts business in British pounds sterling has a program that utilizes forward currency contracts denominated in United States dollars to offset the risk associated with the effects of currency exposure for sales in United States dollars. Under this program, increases or decreases in the subsidiary's foreign currency exposure are offset by gains or losses on the forward contracts, to mitigate the possibility of foreign currency translation gains or losses. These forward contracts generally have terms of 90 days or less. We do not use these forward contracts for trading purposes. All outstanding foreign currency forward contracts used in this program are marked to market at the end of the period with unrealized gains and losses included in other income and expense.

Our ultimate realized gain or loss with respect to currency fluctuations will depend on the currency exchange rates and other factors in effect as the contracts mature. Net foreign exchange translation gains and losses included in other income and expense in the accompanying consolidated statements of operations totaled a $343,000 loss for 2006 and a $123,000 gain for 2005.

A substantial portion of our notes payable and long-term debt have variable interest rates based on the prime interest rate and/or the lender's base rate, which exposes us to risk of earnings loss due to changes in such interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Reference is made to the financial statements included in this report, which begin at page F-1.

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

On April 13, 2006, we notified Grant Thornton LLP ("GT"), the independent registered public accounting firm that was engaged as our principal accountant to audit our consolidated financial statements, that we intended to engage new certifying accountants and thereby were terminating our relationship with GT. Our decision to change accountants was approved by our audit committee and board of directors. The reason for the change was to allow us to engage an alternative firm that we believed had adequate resources and experience to provide us with the auditing and tax services we require, on a more cost-effective basis.

The audit reports of GT on our consolidated financial statements and consolidated financial statement schedules as of and for the years ended December 31, 2005 and 2004 did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles. During the years ended December 31, 2005 and 2004 and the subsequent interim period through April 13, 2006, there were no disagreements with GT on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures which disagreements, if not resolved to GT's satisfaction, would have caused GT to make reference to the subject matter of the disagreement in connection with its opinion.

During the years ended December 31, 2005 and 2004 and the subsequent interim period through April 13, 2006, there were no reportable events as described in Item 304(a)(1)(v) of Regulation S-K under the Securities Act of 1933, as amended, except as described below.

- On April 5, 2005, in connection with its audit of our consolidated financial statements for the year ended December 31, 2004, GT advised our audit committee and management of two matters that GT considered to be "material weaknesses" as that term is defined under standards established by the Public Company Accounting Oversight Board (United States), or PCAOB. A material weakness is a control deficiency or combination of control deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The first matter related to our need for additional staff with expertise in preparing required disclosures in the notes to the financial statements, and our need to develop greater internal resources for researching and evaluating the appropriateness of complex accounting principles and for evaluating the effects of new accounting pronouncements on us. Our growth during and since 2004 as a result of our acquisitions of Larus Corporation, Pascall and RO and the increased complexity surrounding our financing arrangements are major contributors to the need for additional resources in

financial reporting. The second matter related to segregation of duties relating to cash disbursements. Both our assistant controller and accounts payable clerk had access to initiate the payment of invoices and print electronically signed checks. Both individuals had the ability to record transactions in the accounting system. The lack of segregation of these two functions - check-writing ability and the recording of disbursement transactions in our accounting system - represented a material weakness in the cash disbursements cycle. We considered these matters in connection with the preparation of the December 31, 2004 consolidated financial statements and also determined that no prior period financial statements were materially affected by such matters. In response to the observations made by GT, on April 7, 2005, we engaged financial consultants who are certified public accountants with the requisite background and experience to prepare required disclosures in the notes to our financial statements and to provide greater internal resources for researching and evaluating the appropriateness of complex accounting principles and for evaluating the effects that new accounting pronouncements may have on us. In addition, we recognize that the risk of an unauthorized disbursement exists without proper segregation of duties between check-writing and record keeping. However, every month we review the listing of checks produced and research any check number that is missing or questionable. We believe this type of detective control would identify unauthorized disbursements. Additionally, on May 6, 2005, we limited the system access for those individuals performing this review such that there are appropriate mitigating controls over the incompatible duties with regard to our disbursements. We believe these steps addressed the matters GT raised.

o On August 15, 2005, in connection with its review of our condensed consolidated financial statements for the quarter ended June 30, 2005, GT advised our management of a matter that GT considered to be a material weakness. GT noted that we recorded revenue in our Pascall division for certain items previously recorded as "bill and hold" inventory. We had shipped the items to the customer on June 30, 2005, and the customer took title to the items and paid for the items. However, the customer requested that Pascall modify the items and returned the items to Pascall on July 7, 2005 under a separate contract. The return of the items by the customer subsequent to June 30, 2005 resulted in the transaction not meeting the revenue recognition criteria under SAB No. 104. The recording of these items as sales in the quarter ended June 30, 2005 resulted in an adjusting journal entry to reduce revenue by $841,000 and to reduce net income by $314,000 ($0.01 per share). GT met with our audit committee on August 18, 2005 and recommended that we review the control procedures over bill and hold arrangements to determine adherence to SAB No. 104. Our audit committee and management have undertaken an extensive review of SAB No. 104. We have sought and plan to continue to seek guidance from our financial consultants, who are certified public accountants with the requisite background and experience, to assist us in our future compliance with SAB No. 104 as it relates to control procedures over bill and hold matters and believe we have therefore remediated the material weakness. o On March 28, 2006, in connection with its audit of our consolidated financial statements for the year ended December 31, 2005, GT advised our management and audit committee of two matters that GT considered material weaknesses. GT indicated that in the area of accounting and financial reporting, it believed we had insufficient accounting resources to enable us to identify and evaluate complex accounting and reporting matters. In addition, GT recommended that we establish procedures to ensure that our Chief Financial Officer can more

closely monitor information submitted to our corporate headquarters by our subsidiary controllers and oversee accounting for reserves and other areas that involving significant judgment at all company locations. GT also recommended that we establish procedures to ensure that personnel familiar with accounting principles generally accepted in the United States and with Commission disclosure requirements thoroughly evaluate activities and transactions at all company locations in order to determine that we are timely making all required disclosures.

On April 17, 2006, we engaged Hein & Associates LLP as our new certifying accountants. We had not consulted with Hein in the past regarding the application of accounting principles to a specified transaction or the type of audit opinion that might be rendered on our financial statements or as to any disagreement or reportable event as described in Item 304(a)(1)(iv) and Item 304(a)(1)(v) of Regulation S-K.

ITEM 9A. CONTROLS AND PROCEDURES.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We conducted an evaluation, with the participation of our Chief Executive Officer, who is also our Acting Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act"), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures also include, without limitation, controls and procedures designated to ensure that information required to be disclosed by a company in the reports filed or submitted by it under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on that evaluation, our Chief Executive Officer and Acting Chief Financial Officer has concluded as of December 31, 2006 that our disclosure controls and procedures were not effective at the reasonable assurance level due to the material weaknesses described below.

A material weakness is internal control over financial reporting is defined by the Public Company Accounting Oversight Board's Audit Standard No. 2 as being a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements would not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected.

In connection with its audit of our consolidated financial statements for the year ended December 31, 2006, Hein, our independent registered public

accounting firm, advised management and our audit committee of the following two matters that Hein considered to be material weaknesses in the area of accounting and financial reporting:

1. We did not have a sufficient complement of personnel with appropriate training and experience in generally accepted accounting principles in the United States and with Commission disclosure requirements.

2. We lacked procedures to ensure that our principal accounting and financial officer can closely monitor information submitted to our corporate headquarters by our subsidiaries and oversee accounting for reserves and other areas that involve significant judgment at all of our locations. We also lacked procedures to ensure that personnel familiar with accounting principles generally accepted in the United States and with Commission disclosure requirements can thoroughly evaluate activities and transactions at all of our locations in order to make all required disclosures in a timely manner.

To initially address these material weaknesses, management performed additional analyses and other procedures to ensure that the financial statements included herein fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented.

INHERENT LIMITATIONS ON THE EFFECTIVENESS OF CONTROLS

Management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control systems are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, no evaluation of internal control over financial reporting can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been or will be detected.

These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of a simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

REMEDIATION OF MATERIAL WEAKNESSES

To remediate the material weaknesses in our disclosure controls and procedures identified above, we have done or intend to do the following, in the periods specified below:

Our former Chief Financial Officer functioned in that position through August 18, 2006, the date of his resignation from employment with EMRISE

Corporation. Upon his resignation, overall responsibility for the accounting functions and reporting was delegated to our Chief Executive Officer who currently is filling the role of Acting Chief Financial Officer. Management and our audit committee launched a recruitment effort in September 2006, and currently have identified a qualified candidate for the position of Vice President of Finance and Administration (our principal financial and accounting officer) and a qualified candidate for the position of Controller for our United States operations, each with expertise in public company financial reporting compliance. We expect to complete the hiring of these two candidates during the second quarter of 2007.

Once a Vice President of Finance and Administration and a new Controller for our United States operations begin employment with us, we intend that these individuals will develop policies and procedures, including an adequate supervisory structure, necessary to ensure that our principal accounting and financial officer can closely monitor financial information throughout our company and oversee all accounting that involves significant judgment on the part of personnel located at our operating subsidiaries within the United States, Europe and Asia. In addition, we intend that our Vice President of Finance and Administration and new Controller for our United States operations will establish policies and procedures necessary to ensure that personnel familiar with accounting principles generally accepted in the United States and with Commission disclosure requirements are capable of evaluating activities and transactions at all of our operating subsidiaries in order to make all required disclosures in a timely manner. We anticipate that our Vice President of Finance and Administration and our new Controller for our United States operations will work closely with our Director of Financial Controls for Europe, whom we hired in late 2005 to oversee our three European Controllers and who will report to our Vice President of Finance and Administration, on these matters.

Management is unsure, at the time of the filing of this report, when the actions described above will remediate the material weaknesses also described above. Until we hire a Vice President of Finance and Administration and a new Controller for our United States operations, as planned, management may continue to hire outside consultants to assist us in satisfying our financial reporting obligations.

Management believes that a Vice President of Finance and Administration will have an annual base salary of approximately $225,000 and a new Controller for our United States operations will have an annual base salary of approximately $110,000, not including benefits and other costs of employment. Management is unable, however, to estimate our expenditures related to the hiring of outside consultants to assist us in satisfying our financial reporting obligations.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes during the quarter ended December 31, 2006 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

ITEM 9B. OTHER INFORMATION.

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

DIRECTORS AND EXECUTIVE OFFICERS

The names, ages and positions held by our directors, director nominee and executive officers as of March 16, 2007 and their business experience are as follows:

NAME	AGE	TITLES
Carmine T. Oliva	64	Chairman of the Board, President, Chief E Acting Chief Financial Officer, Secretary
Graham Jefferies	49	Executive Vice President, Chief Operating Managing Director of EMRISE Electronics L
Laurence P. Finnegan, Jr. (1)(2)(3)	69	Director
Otis W. Baskin (1)(2)(3)	61	Director
Richard E. Mahmarian (2)(3)	70	Director

----
(1) Member of the compensation committee.
(2) Member of the nominating committee.
(3) Member of the audit committee.

CARMINE T. OLIVA has been Chairman of the Board, President and Chief Executive Officer and a Class III director of EMRISE since March 26, 1997 and of our subsidiary, EMRISE Electronics Corporation, since he founded EMRISE Electronics Corporation in 1983. Mr. Oliva has been Acting Chief Financial Officer and Secretary of EMRISE since August 18, 2006 and served as Acting Chief Financial Officer from April to July 2005. Mr. Oliva has been Chairman of the Board of EMRISE Electronics Ltd. since 1985, and Chairman and Chief Executive Officer of CXR Larus since March 1997. In 2002, Mr. Oliva obtained a French government working permit and assumed responsibility as President of our CXR-AJ subsidiary. From January 1999 to January 2000, Mr. Oliva served as a director of Digital Transmission Systems Inc. (DTSX), a publicly held company based in Norcross, Georgia. From 1980 to 1983, Mr. Oliva was Senior Vice President and General Manager, ITT Asia Pacific Inc. Prior to holding that position, Mr. Oliva held a number of executive positions with ITT Corporation and its subsidiaries over an eleven-year period. Mr. Oliva attained the rank of Captain in the United States Army and is a veteran of the Vietnam War. Mr. Oliva earned a B.A. degree in Social Studies from Seton Hall University and an M.B.A. degree in Business from The Ohio State University.

GRAHAM JEFFERIES was appointed as Executive Vice President on October 21, 1999. Mr. Jefferies was also appointed as our Chief Operating Officer on January 3, 2005, after having served as Chief Operating Officer of our

Telecommunications Group since October 21, 1999. Mr. Jefferies served as Executive Vice President of EMRISE from April 1999 through October 1999. Mr. Jefferies has served CXR-AJ as a director since March 1997 and as General Manager since July 2002, has served as Managing Director of Belix Power Conversions Ltd., Belix Wound Components Ltd. and Belix Company Ltd. since our acquisition of those companies in April 2000, as Managing Director of XCEL Power Systems, Ltd. since September 1996 and as Managing Director of EMRISE Electronics Ltd. since March 1992. Prior to joining us in 1992, he was Sales and Marketing Director of Jasmin Electronics PLC, a major United Kingdom software and systems provider, from 1987 to 1992. Mr. Jefferies held a variety of project management positions at GEC Marconi from 1978 to 1987. Mr. Jefferies earned a B.S. degree in Engineering from Leicester University, and has experience in mergers and acquisitions. Mr. Jefferies is a citizen and resident of the United Kingdom.

LAURENCE P. FINNEGAN, JR. has served as a Class II director since March 26, 1997. In addition to being a director of EMRISE Electronics from 1985 to March 1997, Mr. Finnegan was EMRISE Electronics' part-time Chief Financial Officer from 1994 to 1997. Mr. Finnegan has held positions with ITT (1970-1974) as controller of several divisions, Narco Scientific (1974-1983) as Vice President Finance, Chief Financial Officer, Executive Vice President and Chief Operating Officer, and Fischer & Porter (1986-1994) as Senior Vice President, Chief Financial Officer and Treasurer. Since August 1995, he has been a principal of GwynnAllen Partners, Bethlehem, Pennsylvania, an executive management consulting firm. Since December 1996, Mr. Finnegan has been a director and the President of GA Pipe, Inc., a manufacturing company based in Langhorne, Pennsylvania. From September 1997 to January 2001, Mr. Finnegan served as Vice President Finance and Chief Financial Officer of QuestOne Decision Sciences, an efficiency consulting firm based in Pennsylvania. Since August 2001, Mr. Finnegan has served as a director and the Vice President and Chief Financial Officer of VerdaSee Solutions, Inc., a consulting and software company based in Pennsylvania. Mr. Finnegan earned a B.S. degree in Accounting from St. Joseph's University.

OTIS W. BASKIN has served as a Class I director since February 6, 2004. He has been a Professor of Management at The George L. Graziadio School of Business and Management at Pepperdine University in Malibu, California since June 1995 and also served as dean from 1995 to 2001. He has been a member of the full-time faculty of the University of Houston - Clear Lake (1975-87), where he served as Coordinator of the Management Faculty and Director of the Center for Advanced Management Programs. He has also been Professor of Management at Arizona State University, West Campus (1987-91) and The University of Memphis (1991-95), in addition to serving as dean at both universities. Dr. Baskin worked with AACSB International (Association for the Advancement of Collegiate Schools of Business) as Special Advisor to the President and as Chief Executive Officer from July 2002 to June 2004. He is an Associate with the Family Business Consulting Group, where he advises family owned and closely held businesses. He has served as an advisor to Exxon/Mobile Research and Engineering Corporation, NASA and the United States Air Force. He earned a Ph.D. in Management, Public Relations and Communication Theory from The University of Texas at Austin, an M.A. degree in Speech Communication from the University of Houston, and a B.A. degree in Religion from Oklahoma Christian University.

RICHARD E. MAHMARIAN was appointed as a Class III director on March 1, 2006. He has served as a principal and Chairman, President and Chief Executive Officer of Control Solutions, Inc., a company that specializes in providing

business systems including hardware, software, consumable products and services to major United States corporations, since December 2003. Mr. Mahmarian also has served as managing member and Chairman and Chief Executive Officer of REM Associates, LLC, a private investment and consulting company, since 1997. Mr. Mahmarian also owns R&R Palos Verdes Enterprises, Inc., a home construction company in the south bay area of Los Angeles, California, which was started in 1997. From 1998 until 2001, Mr. Mahmarian was the owner of Alpha Microsystems, LLC, a company that manufactured and sold mini-computer systems, personal computers and servers, provided network services and support, and information technology hardware and software services throughout North America through 50 field offices. He served in the U.S. Navy and was honorably discharged. While in the Navy, he received extensive training in advanced electronic technologies. Mr. Mahmarian earned a B.A. degree in Accounting from Upsala College and an M.B.A. in Marketing and Economics from Seton Hall University.

BOARD OF DIRECTORS

Our business, property and affairs are managed under the direction of our board. Directors are kept informed of our business through discussions with our executive officers, by reviewing materials provided to them and by participating in meetings of our board and its committees.

Our bylaws provide that our board of directors shall consist of at least four directors. Our board is divided into three classes of directors: Class I, Class II and Class III. The term of office of each class of directors is three years, with one class expiring each year at our annual meeting of stockholders. We currently have four directors on our board, with no vacancies. Our current board consists of one Class I director whose term expires at our 2009 annual meeting, one Class II director whose term expires at our 2007 annual meeting, and two Class III directors whose term expires at our 2008 annual meeting.

APPOINTMENT OF OFFICERS; NO FAMILY RELATIONSHIPS

Our officers are appointed by and serve at the discretion of our board of directors. There are no family relationships among our executive officers and directors.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our executive officers and directors, and persons who beneficially own more than 10% of a registered class of our common stock, to file initial reports of ownership and reports of changes in ownership with the Commission. These officers, directors and stockholders are required by the Commission regulations to furnish us with copies of all reports that they file.

Based solely upon a review of copies of the reports furnished to us during the year ended December 31, 2006 and thereafter, or any written representations received by us from directors, officers and beneficial owners of more than 10% of our common stock ("reporting persons") that no other reports were required, we believe that, during 2006, all Section 16(a) filing requirements applicable to our reporting persons were met, except that Austin W. Marxe and David M. Greenhouse filed three late Form 4s to report three transactions.

CODE OF ETHICS

Our board of directors has adopted an Amended and Restated Code of Business Conduct and Ethics that applies to all of our directors, officers and employees and an additional Code of Business Ethics that applies to our Chief Executive Officer and senior financial officers. We filed copies of these codes as exhibits to the initial filing of our annual report on Form 10-K for the year ended December 31, 2005.

We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K relating to amendments to or waivers from provision of these codes that relate to one or more of the items set forth in Item 406(b) of Regulation S-K, by describing on our Internet website, located at http://www.emrise.com, within four business days following the date of a waiver or a substantive amendment, the date of the waiver or amendment, the nature of the amendment or waiver, and the name of the person to whom the waiver was granted. Information on our Internet website is not, and shall not be deemed to be, a part of this report or incorporated into any other filings we make with the Commission.

AUDIT COMMITTEE MATTERS

Messrs. Finnegan and Baskin served on our audit committee throughout and since 2006, with Mr. Finnegan serving as chairman. Mr. Mahmarian was appointed as the third member of the audit committee when he joined our board on March 1, 2006. Our board of directors has determined that Messrs. Finnegan and Mahmarian are audit committee financial experts and qualify as independent under Rule 5.3(k) of the NYSE Arca Equities Rules and Rule 10A-3(b)(1) of the Commission.

PROCEDURES FOR NOMINATIONS BY SECURITY HOLDERS

Since last disclosed by us, no material changes have been implemented to the procedures by which security holders may recommend nominees to our board.

ITEM 11. EXECUTIVE COMPENSATION.

COMPENSATION DISCUSSION AND ANALYSIS

COMPENSATION PHILOSOPHY AND COMPONENTS

This section discusses the principles underlying our executive compensation policies and decisions and the most important factors relevant to an analysis of these policies and decisions. It provides qualitative information regarding the manner and context in which compensation is awarded to and earned by our executive officers and places in perspective the data presented in the tables and narrative that follow.

Our compensation committee is responsible for reviewing and approving base salaries, bonuses and incentive awards for all executive officers, reviewing and establishing the base salary, bonuses and incentive awards for the chief executive officer, and reviewing, approving and recommending to the board of directors the content, terms and conditions of all employee compensation and benefit plans, or changes to those plans.

Our compensation philosophy is based upon four central objectives:

- To provide an executive compensation structure and system that is both competitive in the outside industrial marketplace and also internally equitable based upon the weight and level of

responsibilities in the respective executive positions;

- To attract, retain and motivate qualified executives within this structure, and reward them for outstanding performance-to-objectives and business results through financial and other appropriate management incentives;

- To align our financial results and the compensation paid to our executive officers with the enhancement of stockholder value; and

- To structure our compensation policy so that executive officers' compensation is dependent, in one part, on the achievement of its current year business plan objectives, and in another part, on the long-term increase in company net worth and the resultant improvement in stockholder value, and to maintain an appropriate balance between short- and long-range performance objectives over time.

Our executive officers' compensation currently has three primary components -- base compensation or salary, annual discretionary cash bonuses, and stock option awards granted pursuant to our Amended and Restated 2000 Stock Option Plan. In addition, we provide our executive officers a variety of benefits that generally are available to all salaried employees in the geographical location where they are based.

We view the various components of compensation as related but distinct. Although our compensation committee does review total compensation, we do not believe that significant compensation derived from one component of compensation should negate or reduce compensation from other components. We determine the appropriate level for each compensation component based in part, but not exclusively, on our view of internal equity and consistency, and other considerations we deem relevant, such as rewarding extraordinary performance. Our compensation committee has not adopted any formal or informal policies or guidelines for allocating compensation between long-term and currently paid out compensation, between cash and non-cash compensation, or among different forms of non-cash compensation.

BASE COMPENSATION

Base compensation is targeted to recognize each executive officer's unique value and historical contributions to our success in light of salary norms in our industries and the general marketplace. The criteria for measurement include data available from objective, professionally-conducted market studies, integrated with additional competitive intelligence secured from a range of industry and general market sources. Our compensation committee reviews the base compensation of the chief executive officer, and with the chief executive officer, the base compensation of all other executive officers, periodically to assure that a competitive position is maintained.

EQUITY COMPENSATION

We use stock options to reward long-term performance. Our compensation committee and/or our board of directors act as the manager of our option plans and perform functions that include selecting option recipients, determining the timing of option grants and whether options are incentive or non-qualified, and assigning the number of shares subject to each option, fixing the time and

manner in which options are exercisable, setting option exercise prices and vesting and expiration dates, and from time to time adopting rules and regulations for carrying out the purposes of our plans. For compensation decisions regarding the grant of equity compensation to executive officers, our compensation committee typically considers recommendations from our chief executive officer.

We do not have any program, plan or obligation that requires us to grant equity compensation on specified dates. We have not made equity grants in connection with the release or withholding of material non-public information. Historically, options granted to our directors and executive officers have generally had exercise prices above the then trading price of our common stock. Information about outstanding options held by our named executive officers and directors is contained in the "Outstanding Equity Awards at December 31, 2006" and "Director Compensation" tables.

CASH BONUSES

Executive bonuses are used to focus our management on achieving key corporate financial objectives, to motivate certain desired individual behaviors and to reward substantial achievement of these company financial objectives and individual goals. We use cash bonuses to reward performance achievements generally only as to years in which we are substantially profitable, and we use salary as the base amount necessary to match our competitors for executive talent.

Bonuses, if any, are determined and paid on an annual basis after completion of the bonus year. We did not pay any bonuses to our named executive officers for 2005 and do not anticipate paying any such bonuses for 2006.

In the past, our compensation committee has based bonuses for our named executive officers on net income and revenue growth because it believes that as a growth company, we should reward growth in net income and revenue, but only if the revenue growth is achieved cost-effectively. Likewise, our compensation committee believes a profitable company with little or no growth is not acceptable. Our compensation committee considers the chosen metrics of net income and growth in revenue to be the best indicators of our financial success and creation of stockholder value.

56

Individual performance objectives are determined by the executive officer to whom the potential bonus recipient reports or, in the case of our chief executive officer, by our compensation committee. For example, the basis for Mr. Oliva's bonus might include such objectives as developing bank and equity financing, successfully concluding and integrating acquisitions, developing strategic opportunities or developing our executive team.

Our compensation committee has not considered whether it would attempt to recover bonuses paid based on our financial performance where our financial statements are restated in a downward direction sufficient to reduce the amount of bonus that should have been paid under applicable bonus criteria.

ACCOUNTING AND TAX TREATMENT

We account for equity compensation paid to our employees under the rules of SFAS No. 123R, which requires us to estimate and record an expense over the service period of the award. Accounting rules also require us to record cash

compensation as an expense at the time the obligation is accrued. Unless and until we achieve sustained profitability, the availability to us of a tax deduction for compensation expense will not be material to our financial position. We structure cash bonus compensation so that it is taxable to our executives at the time it becomes available to them. We currently intend that all cash compensation paid will be tax deductible for us. However, with respect to equity compensation awards, while any gain recognized by employees from nonqualified options should be deductible, to the extent that an option constitutes an incentive stock option, gain recognized by the optionee will not be deductible if there is no disqualifying disposition by the optionee. In addition, if we grant restricted stock or restricted stock unit awards that are not subject to performance vesting, they may not be fully deductible by us at the time the award is otherwise taxable to the employee.

OTHER BENEFITS

We also maintain other executive benefits that we consider necessary in order to offer fully competitive opportunities to its executive officers. These include, without limitation, 401(k) retirement savings plans, car allowances and employment agreements. The compensation committee continues to monitor and evaluate our executive compensation system and its application throughout our organization to assure that it continues to reflect our compensation philosophy and objectives.

Executive officers are eligible to participate in all of our employee benefit plans, such as medical, dental, group life, disability, and accidental death and dismemberment insurance, in each case on the same basis as other employees. Our officers and employees in Europe generally have somewhat different employee benefit plans than those we offer domestically, typically based on the requirements of their respective countries of domicile.

During 2006, we matched $1,532, which was the lesser of $2,000 and 20% of Mr. Foote's contributions to his 401(k) account. This matching arrangement was generally made available to all employees of EMRISE Corporation and provides for the same method of allocation of benefits between management and non-management participants. Also, one of our subsidiaries, XPS, makes matching contributions of up to 6% of Mr. Jefferies' salary to an executives' defined contribution plan. Other employees of XPS may receive matching contributions to a defined contribution plan of up to 4% of their salary. Amounts contributed to the defined contribution plans are intended to be used to purchase annuities upon retirement. During 2006, Mr. Jefferies received a matching contribution of $17,131, which was 6% of his salary.

SUMMARY COMPENSATION TABLE - 2006

The following table provides information concerning the compensation for the year ended December 31, 2006 for our principal executive officer, our principal financial officer and our chief operating officer, who was the only other person who served as an executive officer during 2006 (collectively, the "named executive officers"). In August 2006, Mr. Foote resigned his positions with us, Mr. Oliva assumed the position of Acting Chief Financial Officer and, as described under the heading "Potential Payments on Termination of Employment or Change-in-Control," Mr. Foote assumed temporary employment with us.

NAME AND PRINCIPAL POSITION	YEAR	SALARY ($)	ALL OTHER COMPENSATION ($)	TOTAL ($)
Carmine T. Oliva Chief Executive Officer	2006	350,000	13,821(1)	363,821
Graham Jefferies (2) Chief Operating Officer	2006	279,165	27,216(3)	306,381
Randolph D. Foote Former Chief Financial Officer	2006	183,750(4)	8,732(5)	192,482

----

(1) Represents $4,821 of insurance premiums we paid with respect to a $1,000,000 term life insurance policy for the benefit of Mr. Oliva's spouse and a $9,000 cash car allowance.
(2) Mr. Jefferies is based in the United Kingdom and receives his remuneration in British pounds sterling. The compensation amounts listed for Mr. Jefferies are shown in United States dollars, converted from British pounds sterling using the average monthly conversion rates in effect during 2006.
(3) Represents $17,131 in company contributions to Mr. Jefferies' retirement account and a $10,085 cash car allowance.
(4) Includes $13,461 of vacation accrual that was paid to Mr. Foote in connection with his resignation.
(5) Represents $1,532 in company contributions to Mr. Foote's 401(k) retirement account and a $7,200 cash car allowance.

EMPLOYMENT AGREEMENTS

CARMINE T. OLIVA

On February 24, 2006, we executed a five-year employment agreement with Carmine T. Oliva, our Chairman of the Board, President and Chief Executive Officer. The agreement became effective as of January 1, 2006 and replaced his previous employment agreement that was scheduled to automatically renew on that date. The agreement provided for an initial base salary of $350,000 during the first twelve months the agreement was in effect. Mr. Oliva is eligible to receive increases and bonuses at the discretion of our compensation committee and to participate in benefit and incentive programs we may offer.

The agreement contains non-competition provisions that prohibit Mr. Oliva from engaging or participating in a competitive business or soliciting our customer or employees during his employment with us and for two years afterward. The agreement also contains provisions that restrict disclosure by Mr. Oliva of our confidential information and assign ownership to us of inventions created by him in connection with his employment. In addition, the agreement contains termination and change-in-control provisions as described under "Potential Payments on Termination of Employment or Change-in-Control."

58

GRAHAM JEFFERIES

On February 24, 2006, we entered into a three-year employment agreement with Graham Jefferies, our Executive Vice President and Chief Operating Officer. The agreement became effective as of January 1, 2006 and replaced his previous

employment agreement that was scheduled to expire in July 2006. The agreement provides for an initial base salary of 152,800 British pounds sterling per year (approximately $263,350 as of January 1, 2006) during the first twelve months that the agreement is in effect, which amount is to be paid by our subsidiary, EMRISE Electronics Ltd. Mr. Jefferies is eligible to receive increases and bonuses at the discretion of our compensation committee and to participate in other benefit and incentive programs we may offer.

The agreement contains non-competition provisions that prohibit Mr. Jefferies from engaging or participating in a competitive business or soliciting our customer or employees during his employment with us and for two years afterward. The agreement also contains provisions that restrict disclosure by Mr. Jefferies of our confidential information and assign ownership to us of inventions created by Mr. Jefferies in connection with his employment. In addition, the agreement contains termination and change-in-control provisions as described under "Potential Payments on Termination of Employment or Change-in-Control."

RANDOLPH D. FOOTE

On February 24, 2006, we entered into a two-year employment agreement with Randolph D. Foote, our then Senior Vice President, Chief Financial Officer and Secretary. The agreement was effective as of January 1, 2006 and replaced his existing employment agreement that was scheduled to expire in July 2006. The agreement provided for an initial base salary of $175,000 during the first twelve months the agreement was to be in effect. Mr. Foote was eligible to receive increases and bonuses at the discretion of our compensation committee and to participate in other benefit and incentive programs we may offer. As described under "Termination of Employment and Change in Control Arrangements," Mr. Foote's employment agreement was terminated in August 2006.

GRANTS OF PLAN-BASED AWARDS

No plan-based awards were granted to the named executive officers during 2006.

OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2006

The following table sets forth information about outstanding equity awards held by our named executive officers as of December 31, 2006.

	OPTION AWARDS		
NAME	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS (#) EXERCISABLE	OPTION EXERCISE PRICE ($)	OPTION EXPIRATION DATE
Carmine T. Oliva	100,000	0.50	01/31/2011
	53,000	0.35	01/22/2013
	26,000	1.00	02/24/2014
	50,000	2.00	12/29/2015

Graham Jefferies	60,000	0.20	11/15/2009
	30,000	1.13	05/01/2008
	54,000	0.35	01/22/2013
	40,000	1.00	02/24/2014
	50,000	2.00	12/29/2015
Randolph D. Foote	50,000	0.20	11/15/2009 (1)
	35,000	0.35	01/22/2013 (1)
	25,000	1.00	02/24/2014 (1)
	50,000	2.00	12/29/2015 (1)

----

(1) Mr. Foote's options are scheduled to expire three months after the termination of his temporary employment with us. His temporary employment with us is expected to terminate no later than April 30, 2007.

OPTION EXERCISES AND STOCK VESTED

No option awards were exercised by any of the named executive officers during the year ended December 31, 2006. No stock awards were held by any of the named executive during the year ended December 31, 2006.

POTENTIAL PAYMENTS ON TERMINATION OF EMPLOYMENT OR CHANGE-IN-CONTROL

The following discussions and tables describe and illustrate potential payments to Messrs. Oliva and Jefferies under existing contracts, agreements, plans or arrangements, whether written or unwritten, for various scenarios involving a change-in-control or termination of employment, assuming a December 31, 2006 termination date.

The tables do not include any prorated incentive bonus that would be payable upon termination for death, incapacity, good reason or without due cause because no bonuses were payable for 2006. Mr. Jefferies is based in the United Kingdom and receives his remuneration in British pounds sterling. The amounts listed for Mr. Jefferies are shown in United States dollars, converted from British pounds sterling using the exchange rate of $1.958 per British pound sterling in effect on December 31, 2006.

CARMINE T. OLIVA

As described under the heading "Summary Compensation Table - Employment Agreements," we are a party to a employment agreement with Carmine T. Oliva, our Chairman of the Board, President and Chief Executive Officer. If we terminate Mr. Oliva's employment for due cause or due to Mr. Oliva's breach of his employment agreement by refusing to continue his employment, our obligation to pay any further compensation, severance allowance, or other amounts payable under the agreement terminates on the date of termination, other than benefits under retirement and benefit plans and programs that are earned and vested by the date of termination, pro rata annual salary through the date of termination, any stock options that have vested as of the date of termination, and accrued vacation as required by California law. "Due cause" includes any intentional misapplication of our funds or other material assets, or any other act of dishonesty injurious to us, or conviction of a felony or a crime involving moral turpitude. "Due cause" also includes abuse of controlled substances or alcohol and breach, nonperformance or nonobservance of any of the terms of the agreement, provided that Mr. Oliva fails to satisfactorily remedy the

performance problem following 90 days' written notice.

We may terminate Mr. Oliva's employment immediately upon written notice to him. Mr. Oliva may terminate the agreement at any time for good reason within 30 days after he learns of the event or condition constituting good reason. "Good reason" includes: changes in Mr. Oliva's position, duties, responsibilities, titles or status; a reduction in his base salary to an amount less than the greater of $350,000 or 10% below the base salary in effect at the time of the reduction; our failure to continue in effect benefits required under the agreement, to obtain the assumption of the agreement by any successor or assign, or to timely cure any material breach after Mr. Oliva gives us written notice; a material reduction in support services, staff, office space and accouterments which reduction is not generally effective for all officers; or if we avail ourselves of or are subjected by any third party to any other proceeding involving insolvency or the protection of or from creditors and the proceeding is not discharged or terminated within 90 days.

If Mr. Oliva's service terminates without due cause or for good reason prior to the expiration of the agreement on January 1, 2011, Mr. Oliva will be entitled to his salary through the end of the month in which termination occurs plus credit for accrued vacation, a severance payment equal to three times his then current annual salary, net of taxes, a prorated incentive bonus, if any, for the fiscal year during which termination occurs, and all medical and life insurance benefits to which he was entitled immediately prior to the date of termination (or at the election of Mr. Oliva in the event of a change-in-control, immediately prior to the date of the change-in-control) for a period of three years or the date or dates that Mr. Oliva's continued participation in our medical and/or life insurance plans is not possible under the plans, whichever is earlier. If our medical and/or life insurance plans do not allow Mr. Oliva's continued participation, then we are required to pay to Mr. Oliva, in monthly installments, the monthly premium or premiums that had been payable by us covering the three-year period.

A "change-in-control" includes: a consolidation or merger in which we are not the surviving corporation or pursuant to which all or substantially all of our common stock would be converted into cash, securities or other property, other than a merger in which the holders of our common stock immediately prior to the merger have the same proportionate ownership of common stock of the surviving corporation immediately after the merger; a sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all, or substantially all, of our assets; stockholder approval of any plan or proposal for liquidation or dissolution; any person other than persons who were stockholders on January 1, 2006, becomes the beneficial owner of 50% or more of our outstanding common stock; during any period of two consecutive years, individuals who at the beginning of such period constitute the entire board cease to constitute a majority of the board unless the election, or the nomination for election by our stockholders, of each new director was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of the period; or there is any change of control of a nature required to be reported in response to Item 6 (e) of Schedule 14A under the Exchange Act.

If Mr. Oliva becomes mentally or physically incapable of performing the services required under the agreement for a period of 240 consecutive days, and the incapacity is confirmed by the written opinion of two practicing medical doctors, we may terminate Mr. Oliva's employment under the agreement upon 30

days' prior written notice. Upon Mr. Oliva's death, the agreement will terminate immediately. If Mr. Oliva's employment is terminated due to his incapacity or death, Mr. Oliva or his estate or legal representative will be entitled to receive benefits under our retirement and benefits plans and programs that are earned and vested at the date of termination, a prorated incentive bonus for the fiscal year in which incapacity or death occurs, and Mr. Oliva's annual salary then in effect for one year following the date of termination, offset, however, by any payments received by Mr. Oliva as a result of any disability insurance maintained by us for Mr. Oliva's benefit.

CARMINE T. OLIVA	CASH SEVERANCE PAYMENT(S)	TAX GROSS UP	TOTAL CASH SEVERANCE PAYMENT(S)	CONTINUATION GROUP MEDIC AND LIFE INSURANCE
Due Cause, Retirement or Voluntary Termination	$0	$0	$0	$0
Death or Incapacity	$350,000, representing one times annual salary, payable in semi-monthly installments over one year	$0	$350,000	$0
Good Reason or Without Due Cause	$1,050,000, representing three times annual salary, payable in lump sum $29,167 payable in lump sum for accrued vacation	$710,563, assuming 40.36% effective tax rate	$1,789,730	$36,387, represent premiums payable for to three ye

GRAHAM JEFFERIES

As described under the heading "Summary Compensation Table - Employment Agreements," we are a party to a employment agreement with Graham Jefferies, our Executive Vice President and Chief Operating Officer. If Mr. Jefferies' employment terminates for due cause or due to Mr. Jefferies' breach of the agreement by refusing to continue his employment, our obligation to pay any further compensation, severance allowance, or other amounts payable under the agreement terminates on the date of termination, other than benefits under retirement and benefit plans and programs that are earned and vested by the date of termination, Mr. Jefferies' pro rata annual salary through the date of termination, any stock options that have vested as of the date of termination, and accrued vacation as required by applicable law.

We may terminate Mr. Jefferies' employment immediately upon written

notice. Mr. Jefferies may terminate the agreement at any time for good reason within 30 days after Mr. Jefferies learns of the event or condition constituting good reason. If termination without due cause by us or for good reason by Mr. Jefferies occurs prior to the expiration of the agreement on January 1, 2009, Mr. Jefferies will be entitled to his salary through the end of the month during which the termination occurs plus credit for accrued vacation, a severance payment in an amount equal to two times his then current annual salary, net of applicable taxes, a prorated incentive bonus, if any, for the fiscal year during which termination occurs, and all medical and life insurance benefits to which Mr. Jefferies was entitled immediately prior to the date of termination (or at the election of Mr. Jefferies in the event of a change-in-control, immediately prior to the date of the change-in-control) for a period of two years or the date or dates that Mr. Jefferies' continued participation in our medical and/or life insurance plans is not possible under the plans, whichever is earlier. If our medical and/or life insurance plans do not allow Mr. Jefferies' continued participation, then we will be obligated to pay to Mr. Jefferies, in monthly installments, the monthly premium or premiums that had been payable by us covering the two-year period.

If Mr. Jefferies becomes mentally or physically incapable of performing the services required under the agreement for a period of 180 consecutive days, the agreement will terminate; provided, however, that Mr. Jefferies will remain an employee of EMRISE Electronics Ltd. and will be entitled to remuneration in an amount equal to the amount paid under EMRISE Electronics Ltd.'s permanent health scheme, subject to the paragraph immediately below. Upon Mr. Jefferies' death, the agreement will terminate immediately.

If Mr. Jefferies' employment is terminated due to his incapacity or death, Mr. Jefferies or his estate or legal representative will be entitled to receive benefits under retirement and benefits plans and programs that are earned and vested at the date of termination, a prorated incentive bonus for the fiscal year in which incapacity or death occurs, and Mr. Jefferies' annual salary then in effect for one year following the date of termination, offset by any payments received by Mr. Jefferies as a result of any permanent insurance scheme maintained by us for Mr. Jefferies' benefit.

The terms "due cause," "good reason" and "change-in-control" have the same meanings as in Mr. Oliva's employment agreement described above.

GRAHAM JEFFERIES	CASH SEVERANCE PAYMENT(S)	TAX GROSS UP	TOTAL CASH SEVERANCE PAYMENT(S)	CONTINUATION GROUP MEDIC AND LIFE INSURANCE
Due Cause, Retirement or Voluntary Termination	$0	$0	$0	$0
Death or Incapacity	$299,182, representing one times annual salary, payable in semi-monthly installments over one year	$0	$299,182	$1,566, represents estimated permanent health schem premiums for one year
Good Reason or Without Due Cause	$598,364, representing two times annual salary, payable	$398,909, assuming 40.0% effective	$997,273	$9,334, represent premiums payable for

in lump sum tax rate to two yea

RANDOLPH D. FOOTE

As described under the heading "Summary Compensation Table - Employment Agreements," we were a party to an employment agreement with Randolph D. Foote, our former Senior Vice President, Chief Financial Officer and Secretary. On August 18, 2006, Mr. Foote resigned from all positions with us and our subsidiaries. We entered into a resignation and separation agreement with him, which became effective on August 25, 2006. Under the agreement, Mr. Foote resigned all of his positions with us, and we and Mr. Foote jointly terminated his employment agreement dated effective as of January 1, 2006. The resignation and separation agreement provided that effective as of August 21, 2006, Mr. Foote would be assigned to temporary employment with us, which we and Mr. Foote anticipated would terminate by approximately December 31, 2006. On December 31, 2006, we and Mr. Foote amended the separation agreement to extend Mr. Foote's temporary employment to no later than March 30, 2007. We and Mr. Foote intend to amend the separation agreement to extend Mr. Foote's temporary employment to no later than April 30, 2007. During the time of his temporary employment, Mr. Foote has been assisting us in, among other things, the preparation of our restated financial statements and our filings with the Commission and has continued to receive his base salary and employment benefits (other than paid vacation benefits, bonus or incentive compensation). Mr. Foote's stock options are scheduled to terminate three months after termination of his temporary employment. For twelve months following termination of his temporary employment, Mr. Foote has agreed to continue to provide reasonable cooperation and assistance to us as needed, and subject to Mr. Foote's performance of his obligations under the separation agreement, we have agreed to pay to Mr. Foote in installments on our regular pay dates during that period the total gross amount of $182,200 and to reimburse Mr. Foote for health plan benefit premiums at the same benefit level he had as of his resignation date.

DIRECTOR COMPENSATION

Each non-employee director is entitled to receive $1,000 per month as compensation for his services. In addition, each board member chairing a standing committee is entitled to receive $500 per month as compensation for his services. We reimburse all directors for out-of-pocket expenses incurred in connection with attendance at board and committee meetings. We may periodically award options or warrants to our directors under our existing option and incentive plans. On April 16, 2006, we granted to Mr. Mahmarian an option to purchase 50,000 shares of our common stock at an exercise price of $1.00 per share. The option vests in two equal installments of 25,000 shares on October 17, 2006 and April 17, 2007.

The following table provides information concerning the compensation of our directors for the year ended December 31, 2006.

NAME	FEES EARNED OR PAID IN CASH ($)	OPTION AWARDS ($)	TOTAL ($)

Laurence P. Finnegan, Jr.	18,000	-(1)	18,000
Otis W. Baskin	18,000	-(2)	18,000
Richard E. Mahmarian	14,400	39,000(3)	53,400

----

(1) At December 31, 2006, Mr. Finnegan held options to purchase an aggregate of 216,000 shares of common stock.

(2) At December 31, 2006, Mr. Baskin held options to purchase an aggregate of 85,000 shares of common stock.

(3) The dollar amount reflected in the table is the compensation cost we recognized for financial statement reporting purposes during 2006 under SFAS 123R for the grant made to Mr. Mahmarian in 2006, estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of 0%; expected volatility of 87%; risk-free interest rate of 4.75%; expected option life of 7 years; and weighted-average fair value per share of $0.79. At December 31, 2006, Mr. Mahmarian held options to purchase an aggregate of 50,000 shares of common stock, all of which were granted during 2006.

64

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Throughout and since 2006, the compensation committee has consisted of Messrs. Finnegan and Mr. Baskin. No member of the board of directors has a relationship that would constitute an interlocking relationship with executive officers and directors of another entity.

COMPENSATION COMMITTEE REPORT

Our compensation committee reviewed and discussed with our management the "Compensation Discussion and Analysis" contained in this proxy statement. Based on that review and discussions, our compensation committee recommended to our board of directors that the "Compensation Discussion and Analysis" be included in this proxy statement.

Compensation Committee
EMRISE Corporation
Otis W. Baskin, Chairman
Laurence P. Finnegan, Jr., Member

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

BENEFICIAL OWNERSHIP TABLE

Except as otherwise indicated in the related footnotes, the following table sets forth information with respect to the beneficial ownership of our common stock as of March 16, 2007, by:

- each person known by us to beneficially own more than 5% of the outstanding shares of our common stock;
- each of our directors;
- each of the "named executive officers" named in the "Summary Compensation Table -- 2006" contained in the "Management" section of this report; and

o all of our directors and executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the Commission, and includes voting or investment power with respect to the securities. To our knowledge, except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table below have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them. Except as indicated in the discussion of contractual beneficial ownership limitations below and except as indicated in the footnotes to the principal stockholders table below, shares of common stock underlying derivative securities, if any, that currently are exercisable or convertible or are scheduled to become exercisable or convertible for or into shares of common stock within 60 days after the date of the table are deemed to be outstanding in calculating the percentage ownership of each listed person or group but are not deemed to be outstanding as to any other person or group. Percentage of beneficial ownership is based on 38,136,750 shares of common stock outstanding as of the date of the table.

65

The warrants described in the footnotes to the table contain provisions limiting the exercise of the warrants to the extent necessary to insure that following the exercise, the total number of shares of common stock then beneficially owned by the warrant holder and its affiliates and others whose beneficial ownership would be aggregated with the holder's for purposes of Section 13(d) of the Exchange Act does not exceed 9.999% of the total number of then issued and outstanding shares of our common stock (including for such purpose the shares of common stock issuable upon such exercise or call). The 9.999% beneficial ownership limitation may not be waived. However, the beneficial ownership limitation does not preclude a holder from exercising a warrant and selling the shares underlying the warrant in stages over time where each stage does not cause the holder and its affiliates to beneficially own shares in excess of the limitation amount.

The address of each of the following stockholders, unless otherwise indicated in the footnotes to the table, is c/o EMRISE Corporation, 9485 Haven Avenue, Suite 100, Rancho Cucamonga, California 91730. Messrs. Oliva, Finnegan, Baskin, and Mahmarian are directors of EMRISE Corporation. Messrs. Oliva and Jefferies are named executive officers and current executive officers of EMRISE Corporation. Mr. Foote is a named executive officer who is no longer an executive officer of EMRISE Corporation.

NAME OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP
Carmine T. Oliva	1,398,305(1)
Laurence P. Finnegan, Jr.	260,171(2)
Otis W. Baskin	120,000(3)
Richard E. Mahmarian	60,000(4)
Graham Jefferies	237,276(5)
Randolph D. Foote	170,000(6)
Austin W. Marxe and David M. Greenhouse	4,516,560(7)
Gruber and McBaine Capital Management, LLC, Jon D. Gruber, J. Patterson McBaine and Eric B. Swergold	2,421,600(8)

All executive officers and directors as a group (4 persons)...... 1,985,752(9)

----

* Less than 1.00%

(1) Includes 81,889 shares held individually by Mr. Oliva's spouse, and 229,000 shares underlying options.

(2) Includes 216,000 shares underlying options.

(3) Includes 85,000 shares underlying options.

(4) Includes 50,000 shares underlying options.

(5) Includes 234,000 shares underlying options.

(6) Includes 160,000 shares underlying options.

(7) Based on share beneficial ownership information contained in a Form 4 filed February 2007 , in which Austin W. Marxe and David M. Greenhouse, the controlling principals of AWM Investment Company, Inc. ("AWM"). AWM serves as the general partner of MGP Advisers Limited Partnership, the general partner of and investment advisor to Special Situations Fund III QP, L.P. Messrs. Marxe and Greenhouse share voting and investment power over 4,156,438 shares of common stock owned by Special Situations Fund III QP, L.P. The address for Messrs. Marxe and Greenhouse is 527 Madison Avenue, Suite 2600, New York, New York 10022.

(8) Based in part on share beneficial ownership information contained in a Schedule 13G filed January 26, 2007, in which Gruber and McBaine Capital Management, LLC ("GMCM"), Jon D. Gruber, J. Patterson McBaine and Eric B. Swergold indicated that they constitute a group, each of whom shares voting and dispositive power over 1,691,200 outstanding shares. Also, Mr. Gruber and Mr. McBaine have sole voting and dispositive power over an additional 284,650 and 108,250 shares of our common stock, respectively. In addition, warrants to purchase shares of our common stock are beneficially owned as follows: Gruber and McBaine International - 50,000; Mr. Gruber - 41,250; Mr. McBaine - 21,250; and Lagunitas Partners LP, an investment limited partnership of which GMCM is the general partner - 225,000. GMCM is a registered investment advisor whose clients have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of shares of our common stock. Messrs. Gruber and McBaine are the managers, controlling persons and portfolio managers of GMCM. No individual client's holdings of our common stock are more than 5.0% of our outstanding common stock. The address for these beneficial owners is 50 Osgood Place, Penthouse, San Francisco, California 94133.

(9) Includes 754,000 shares underlying options and 81,889 outstanding shares held individually by Mr. Oliva's wife.

EQUITY COMPENSATION PLAN INFORMATION

The following table gives information about our common stock that may be issued upon the exercise of options, warrants and rights under all of our existing equity compensation plans as of December 31, 2006.

Plan category	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	NU REMA FUT EQ SECU

	(a)	(b)
Equity compensation plans approved by security holders............	1,965,448(1)	$1.08
Equity compensation plans not approved by security holders....	4,161,185(3)	$1.70
Total........................	6,126,633	

----

(1) Represents shares of common stock underlying options that are outstanding under our 1993 Stock Option Plan, our Employee Stock and Stock Option Plan, our 1997 Stock Incentive Plan and our Amended and Restated 2000 Stock Option Plan. The material features of these plans are described in Note 8 to our consolidated financial statements for the years ended December 31, 2006, 2005 and 2004.

(2) Represents shares of common stock available for issuance under options that may be issued under our Amended and Restated 2000 Stock Option Plan.

(3) Represents shares of common stock underlying warrants that are described in Note 8 to our consolidated financial statements for the years ended December 31, 2006, 2005 and 2004.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

DIRECTOR INDEPENDENCE

Our board of directors has determined that each of Messrs. Baskin, Finnegan and Mahmarian is independent under Rule 5.3(k) of the NYSE Arca Equities Rules because none of those directors has, or during the past three years has had, a material relationship with us, either directly or as a partner, stockholder or officer of an organization that has a relationship with us, and none of those directors is disqualified from being deemed independent under any of subparagraphs (A)-(F) of Rule 5.3(k)(1) of the NYSE Arca Equities Rules. Our board of directors has also determined that each of member of the audit committee is independent under Rule 10A-3(b)(1) of the Commission.

Under the NYSE Arca Equities Rules, the non-management members of our board of directors must meet at regularly scheduled executive sessions without management, with a non-management director presiding over each executive session. A presiding director for each session is selected by the board members in attendance at the session based upon the topics to be discussed at the session. The non-management directors can be contacted by calling the chairman of the audit committee. Further, if the non-management directors include directors who are not independent, then we should at least once a year schedule an executive session including only independent directors. Under the NYSE Arca Equities Rules, we must disclose if any member of our nominating committee or compensation committee is not independent.

TRANSACTIONS WITH RELATED PERSONS

We are party to indemnification agreements with each of our directors and executive officers. The indemnification agreements and our certificate of incorporation and bylaws require us to indemnify our directors and officers to the fullest extent permitted by Delaware law.

REVIEW, APPROVAL OR RATIFICATION OF TRANSACTIONS WITH RELATED PERSONS

In January 2007, our board of directors and nominating committee adopted written policies and procedures relating to approval or ratification of "interested transactions" with "related parties." Under the policies and procedures, our nominating committee is to review the material facts of all interested transactions that require the committee's approval and either approve or disapprove of the entry into the interested transactions, subject to certain exceptions, by taking into account, among other factors it deems appropriate, whether the interested transaction is on terms no less favorable than terms generally available to an unaffiliated third-party under the same or similar circumstances and the extent of the related person's interest in the transaction. No director may participate in any discussion or approval of an interested transaction for which he or she is a related party. If an interested transaction will be ongoing, the committee may establish guidelines for our management to follow in its ongoing dealings with the related party and then at least annually must review and assess ongoing relationships with the related party.

Under the policies and procedures, an "interested transaction" is any transaction, arrangement or relationship or series of similar transactions, arrangements or relationships (including any indebtedness or guarantee of indebtedness) in which the aggregate amount involved will or may be expected to exceed $100,000 in any calendar year, we are a participant, and any related party has or will have a direct or indirect interest (other than solely as a result of being a director or a less than 10% beneficial owner of another entity). A "related party" is any person who is or was since the beginning of the last fiscal year for which we have filed a Form 10-K and proxy statement, even if they do not presently serve in that role an executive officer, director or nominee for election as a director, any greater than 5% beneficial owner of our common stock, or any immediate family member of any of the foregoing. Immediate family member includes a person's spouse, parents, stepparents, children, stepchildren, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, and brothers- and sisters-in-law and anyone residing in such person's home (other than a tenant or employee).

The committee has reviewed and pre-approved certain types of interested transactions described below. In addition, our board of directors has delegated to the chair of the committee the authority to pre-approve or ratify (as applicable) any interested transaction with a related party in which the aggregate amount involved is expected to be less than $120,000. Pre-approved interested transactions include:

- Employment of executive officers either if the related compensation is required to be reported in our proxy statement or if the executive officer is not an immediate family member of another executive officer or a director of our company and the related compensation would be reported in our proxy statement if the executive officer was a "named executive officer" and our compensation committee approved (or recommended that the board approve) such compensation.

- Any compensation paid to a director if the compensation is required to be reported in our proxy statement.

- Any transaction with another company at which a related person's only relationship is as an employee (other than an executive officer), director or beneficial owner of less than 10% of that company's shares, if the aggregate amount involved does not exceed the greater of $120,000 or 2% of that company's total annual revenues.

- Any transaction where the related person's interest arises solely from the ownership of our common stock and all holders of our common stock received the same benefit on a pro rata basis (e.g., dividends).

- Any transaction involving a related party where the rates or charges involved are determined by competitive bids.

- Any transaction with a related party involving the rendering of services as a common or contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority.

- Any transaction with a related party involving services as a bank depositary of funds, transfer agent, registrar, trustee under a trust indenture, or similar services.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

FEES AND SERVICES FOR 2006 AND 2005

We dismissed Grant Thornton LLP as our principal accountant on April 13, 2006 and retained Hein & Associates LLP as our principal accountant on April 17, 2006. We had no relationship with Hein & Associates LLP prior to their retention as our principal accountant. On June 28, 2006, we engaged Hein & Associates LLP to reaudit our consolidated financial statements for the years ended December 31, 2005, 2004 and 2003.

The following table sets forth the aggregate fees billed to us by Hein & Associates LLP, our principal accountant, for professional services rendered in the audit of our consolidated financial statements for the year ended December 31, 2006 and the reaudit of our consolidated financial statements for the years ended December 31, 2005, 2004 and 2003.

FEE CATEGORY	2006	2005
Audit Fees	$ 320,000	$ 957,000
Audit-Related Fees	--	--
Tax Fees	53,000	--
All Other Fees	--	--
Total	$ 373,000	$ 957,000

AUDIT FEES. Audit fees in the 2006 column of the above table consist of fees billed for professional services for audit of our 2006 consolidated financial statements and review of the interim consolidated financial statements included in our 2006 quarterly reports and services that are normally provided by an independent registered public accounting firm in connection with statutory and regulatory filings or engagements.

Due to the impracticality of segregating reaudit fees relating solely to 2005, the audit fees shown in the 2005 column of the above table consist of an aggregate of $957,000 of fees billed with respect to the simultaneous reaudit of our consolidated financial statements for 2005, 2004 and 2003 and review of the interim consolidated financial statements included in our quarterly reports for 2005 and services that are normally provided by an independent registered public accounting firm in connection with statutory and regulatory filings or engagements.

AUDIT-RELATED FEES. No audit-related fees were incurred for 2006 or 2005.

TAX FEES. Tax fees for 2006 consisted of fees billed for professional services for tax compliance, tax advice and tax planning. These services include assistance regarding federal, state and international tax compliance, tax audit defense, customs and duties, mergers and acquisitions, and international tax planning. No tax fees were incurred for 2005.

ALL OTHER FEES. No other fees were incurred for 2006 or 2005.

PRE-APPROVAL POLICIES AND PROCEDURES

Our audit committee pre-approves all services provided by our principal accountant. Our audit committee also considers in advance whether or not to approve any non-audit services to be performed by the independent accounting firm required to be approved by the audit committee pursuant to any applicable rules and regulations.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a)(1), (a)(2) and (c) FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

Reference is made to the financial statements and financial statement schedule listed on and attached following the Index to Financial Statements and Financial Statement Schedule contained at page F-1 of this report.

(a)(3) and (b) EXHIBITS

Reference is made to the exhibits listed on the Index to Exhibits that follows the financial statements and financial statement schedule.

EMRISE CORPORATION AND SUBSIDIARIES

INDEX TO FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

	Page
FINANCIAL STATEMENTS	
Report of Independent Registered Public Accounting Firm.................	F-2

Consolidated Balance Sheets as of December 31, 2006 and 2005............ F-3

Consolidated Statements of Operations for the Years Ended December 31, 2006, 2005 and 2004.................................... F-4

Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2006, 2005 and 2004.............................. F-5

Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2006, 2005 and 2004.................................... F-6

Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004.................................... F-7

Notes to Consolidated Financial Statements for the Years Ended December 31, 2006, 2005 and 2004.................................... F-8

FINANCIAL STATEMENT SCHEDULE

Consolidated Schedule II Valuation and Qualifying Accounts for the Years Ended December 31, 2006, 2005 and 2004........................ F-45

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
and Stockholders of EMRISE Corporation

We have audited the accompanying consolidated balance sheets of EMRISE Corporation and subsidiaries, a Delaware corporation, as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of EMRISE Corporation and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The consolidated Schedule II for the years ended December 31, 2006, 2005 and 2004 is presented for purposes of complying with the Securities and Exchange Commission's rules and is not a required part of the basic consolidated financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

As discussed in note 8 to the accompanying consolidated financial statements, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), SHARE-BASED PAYMENT.

/s/ HEIN & ASSOCIATES LLP

Irvine, California
March 30, 2007

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

ASSETS	2006
Current assets:	
Cash and cash equivalents	$ 3,802
Accounts receivable, net of allowance for doubtful accounts of $391 and $379, respectively	9,220
Inventories, net of allowances for inventory obsolescence of $5,657 and $4,053, respectively	10,575
Deferred income taxes	726
Prepaid and other current assets	1,082
Total current assets	25,405
Property, plant and equipment, net	2,245
Goodwill	12,995
Intangible assets other than goodwill, net of accumulated amortization of $743 in 2006 and $350 in 2005	3,546
Other assets	594
	$ 44,785

LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Borrowings under lines of credit	$ 4,310
Current portion of long-term debt	516
Notes payable to stockholders, current portion	500
Accounts payable	4,640
Income taxes payable	519
Accrued expenses	5,309
Total current liabilities	15,794
Long-term debt, less current portion	533
Notes payable to stockholders, less current portion	1,250
Deferred income taxes	1,053
Other liabilities	982
Total liabilities	19,612
Commitments and contingencies (Notes 2, 5, 6 and 12)	
Stockholders' equity:	
Preferred stock, $0.01 par value. Authorized 10,000,000 shares; zero issued and outstanding	--
Common stock, $0.0033 par value. Authorized 150,000,000 shares; issued and outstanding 38,082,000 shares and 37,550,000 shares in 2006 and 2005, respectively	125
Additional paid-in capital	43,083
Accumulated deficit	(18,733)
Accumulated other comprehensive income (loss)	698
Total stockholders' equity	25,173
	$ 44,785

The accompanying notes are an integral part of these consolidated financial statem

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	2006	2005
Net sales	$ 46,384	$ 41,2
Cost of sales	29,413	23,7
Gross profit	16,971	17,5
Operating expenses:		
Selling, general and administrative	16,117	13,7
Engineering and product development	3,085	2,6
(Loss) income from operations	(2,231)	1,2
Other (expense) income:		
Interest expense	(490)	(4

Interest income	89	1
Other (expense) income, net	(364)	2
(Loss) income before income taxes	(2,996)	1,1
Income tax expense (benefit)	619	(2
Net (loss) income	$ (3,615)	$ 1,4
Basic (loss) earnings per share	$ (0.10)	$ 0.
Diluted (loss) earnings per share	$ (0.10)	$ 0.
Outstanding shares:		
Basic	37,981	37,2
Diluted	37,981	38,4

The accompanying notes are an integral part of these consolidated financial stat

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(IN THOUSANDS)

	2006	2005
Net (loss) income	$ (3,615)	$ 1,
Other comprehensive (loss) income:		
Foreign currency translation adjustment	1,568	(1,
Comprehensive (loss) income	$ (2,047)	$

The accompanying notes are an integral part of these consolidated financial stat

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(IN THOUSANDS)

	Series B Convertible Preferred Stock		Common Stock		Additional Paid-in	Accumu
	Shares	Amount	Shares	Amount	Capital	Defi
Balance at December 31, 2003	1	$ 4	23,476	$ 77	$ 25,613	$ (1

Preferred Series B conversions	(1)	(3)	3	--	3	
Preferred Series B redemption	--	(1)	--	--	1	
Stock options exercised	--	--	19	--	5	
Stock issued for Larus acquisition	--	--	1,214	4	996	
Warrants exercised	--	--	65	1	19	
Warrants issued for services	--	--	--	--	38	
Value of warrants issued to acquire Larus	--	--	--	--	72	
Comprehensive income	--	--	--	--	--	
Balance at December 31, 2004	--	--	24,777	82	26,747	(1
Stock options exercised	--	--	106	--	39	
Warrants exercised	--	--	163	--	50	
Issuance of common stock and warrants, net of issuance costs	--	--	12,504	42	16,018	
Warrants issued for services	--	--	--	--	23	
Comprehensive income	--	--	--	--	--	
Balance at December 31, 2005	--	--	37,550	124	42,877	(1
Stock options exercised	--	--	181	--	97	
Warrants exercised	--	--	351	1	286	
Cost of issuing common stock	--	--	--	--	(323)	
Stock option issuance expense	--	--	--	--	131	
Warrants issued for services	--	--	--	--	15	
Comprehensive loss	--	--	--	--	--	(
Balance at December 31, 2006	--	$ --	38,082	$ 125	$ 43,083	$ (1

The accompanying notes are an integral part of these consolidated financia

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(IN THOUSANDS)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (3,615)	$ 1,4
Adjustments to reconcile net (loss) income to cash (used in) provided by operating activities:		
Depreciation and amortization	1,190	9
Deferred income taxes	35	(8
Provision for doubtful accounts	69	1
Provision for warranty reserve	158	
Provision for inventory obsolescence	1,771	1,4
Stock options and warrants issued for services	146	
Changes in operating assets and liabilities net of businesses acquired:		
Accounts receivable	99	3
Inventories	(2,350)	(4

Prepaid and other assets	(419)	(
Accounts payable	(309)	(1,0
Accrued expenses and other liabilities	2,112	(9
Cash (used in) provided by operating activities	(1,113)	1,1
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net purchases of property, plant and equipment	(884)	(2
Cash received from sale of property, plant and equipment	99	
Net cash paid for the acquisition of Pascall	--	(10,1
Net cash paid for the acquisition of RO Associates	--	(4,6
Net cash paid for acquisition of Larus, net of cash acquired	--	
Cash used in investing activities	(785)	(15,0
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds (repayments) of current notes payable	1,027	2,4
Repayments of long-term debt	(697)	(1,6
Proceeds from long-term debt	--	1,0
Cash from warrant/option exercise	384	
Net proceeds from issuance of common stock	(323)	16,0
Cash provided by (used in) financing activities	391	18,0
Effect of exchange rate changes on cash	938	(8
Net increase (decrease) in cash and cash equivalents	(569)	3,3
Cash and cash equivalents at beginning of year	4,371	1,0
Cash and cash equivalents at end of year	$ 3,802	$ 4,3

The accompanying notes are an integral part of these consolidated financial stat

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(IN THOUSANDS)

	2006	2005
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	$ 560	$ 4
Income taxes	82	$ 3
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of subordinated notes for Larus acquisition	$ --	$
Common stock issued upon conversion of redeemable preferred stock	$ --	$
Common stock issued to acquire Larus	$ --	$

============== ===========

The accompanying notes are an integral part of these consolidated financial stat

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND BUSINESS

EMRISE Corporation (the "Company"), operates through three wholly-owned subsidiaries: EMRISE Electronics Corporation ("EMRISE Electronics"), CXR Larus Corporation ("CXR Larus"), and CXR Anderson Jacobson ("CXR-AJ"). EMRISE Electronics and its subsidiaries design, develop, manufacture and market electronic devices for defense, aerospace and industrial markets. CXR Larus and CXR-AJ design, develop, manufacture and market network access and transmission products and communications test equipment. CXR Larus also engages in the manufacture and sale of communication timing and synchronization products. The Company conducts its operations out of various facilities in the United States, France, the United Kingdom and Japan and organizes itself in two product line segments: electronic devices and communications equipment.

BASIS OF PRESENTATION

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include the accounts of the Company and each of its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

REVENUE RECOGNITION

The Company derives revenues from sales of electronic devices and communications equipment products and services. The Company's sales are based upon written agreements or purchase orders that identify the type and quantity of the item being purchased and the purchase price. The Company recognizes revenue when shipment of products has occurred or services have been rendered, no significant obligations remain on the Company's part, and collectibility is reasonably assured based on the Company's credit and collections practices and policies.

The Company recognizes revenue from domestic sales of its electronic devices and communications equipment at the point of shipment of those products. Product returns are infrequent and require prior authorization because the Company's sales are final and the Company quality tests its products prior to shipment to ensure they meet the specifications of the binding purchase orders under which they are shipped. When a distributor requests and receives authorization to return a product, the request must be accompanied by a purchase order for a replacement product. When an end-user requests to return a product, the Company either repairs or replaces the product.

Revenue recognition for products and services provided by the Company's

United Kingdom subsidiaries, which include EMRISE Electronics Ltd. ("EEL"), XCEL Power Systems, Ltd. ("XPS") and Pascall Electronics Ltd. ("Pascall"), 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 all revenue deferred until all services under the contracts have been completed. Engineering/design services were not significant in 2006, 2005 and 2004. Production contracts provide for a specific quantity of products to be produced over a specific period of time. Customers issue binding purchase orders for each suborder to be produced. At the time each suborder is shipped to the customer, the Company recognizes revenue relating to the products included in that suborder. 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. Generally, these products carry a one-year limited parts and labor warranty. The Company's U.K. subsidiaries do not offer customer discounts, rebates or price protection on these products.

The Company recognizes revenue for products sold by its French subsidiary 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. Generally, these products carry a two-year limited parts and labor warranty.

Generally, the Company's electronic devices, network access and transmission products and communication timing and synchronization products carry a one-year limited parts and labor warranty. The Company's communications test instruments and European network access and transmission products carry a two-year limited parts and labor warranty. Products returned under warranty are tested and repaired or replaced at the Company's option. Historically, warranty repairs have not been material. The Company does not offer customer discounts, rebates or price protection on these products.

Revenues from services such as repairs and modifications are recognized when the service has been 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 represented 4.0%, 2.6% and 5.7% of net sales in 2006, 2005 and 2004, respectively.

RO Associates Incorporated ("RO") generates a portion of its revenue from royalties. Royalty income is recognized when the technology rights have transferred to the licensee. For agreements that provide the licensees the right to manufacture and sell our proprietary products, the Company recognizes initial license fee revenue upon delivery of the product technology. The Company recognizes guaranteed minimum license royalties as revenue as they become due. Per unit royalties that exceed the guaranteed minimum are recognized as earned when reported.

Shipping and handling fees billed to customers totaled $163,000 and $261,000 for the years ended December 31, 2006 and 2005, respectively, and were charged to cost of sales. Such amounts were not significant for the year ended December 31, 2004. Shipping and handling fees billed to international customers are included in net sales and totaled less than 1.0% of net sales for the years

ended December 31, 2006, 2005 and 2004. Depending on the operating division, shipping and handling costs are included in cost of sales or selling, general and administrative expenses. Freight is charged to cost of sales and the charge is reversed when the customer is invoiced for the freight.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of all highly liquid investments with an original maturity of three months or less when purchased. As of December 31, 2006, 2005 and 2004, cash in foreign accounts was $3,232,000, $2,447,000 and $1,035,000, respectively.

INVENTORIES

The Company's finished goods electronic devices inventories generally are built to order. The Company's communications equipment inventories generally are built to forecast, which requires the Company to produce a larger amount of finished goods in its communications equipment business so that the Company's customers can promptly be served. The Company's products consist of numerous electronic and other parts, which necessitates that it exercise detailed inventory management. The Company values its inventory at the lower of the

actual cost to purchase or manufacture the inventory (first-in, first-out) or the current estimated market value of the inventory (net realizable value). The Company performs physical inventories at least once a year. The Company regularly reviews inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on its estimated forecast of product demand and production requirements for the next twelve months. Additionally, to determine inventory write-down provisions, the Company reviews product line inventory levels and individual items as necessary and periodically reviews assumptions about forecasted demand and market conditions. Any parts or finished goods that are determined to be obsolete, either in connection with the physical count or at other times of observation, are reserved for and subsequently discarded and written-off.

In addition, the communications equipment industry is 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, the Company's 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. In the future, if the Company's inventory is determined to be overvalued, the Company would be required to recognize such costs in its cost of goods sold at the time of such determination. Likewise, if the Company's inventory is determined to be undervalued, the Company may have over-reported its costs of goods sold in previous periods and would be required to recognize additional operating income at the time of sale. Therefore, although the Company makes every effort to ensure the accuracy of its forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of the Company's inventory and its reported operating results.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed principally using the straight-line method over the useful lives of the assets (or lease term, if shorter) as follows:

Buildings	50 years
Machinery, equipment and fixtures	3-7 years
Leasehold improvements	5 years

Maintenance and repairs are expensed as incurred, while renewals and betterments are capitalized. Research and development costs are expensed as incurred.

LONG-LIVED ASSETS

The Company reviews the carrying amount of its long-lived 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.

PRODUCT WARRANTY LIABILITIES

Generally, the Company's electronic devices, network access and transmission products and communication timing and synchronization products carry a one-year limited parts and labor warranty and the Company's communications test instruments and European network access and transmission products carry a two-year limited parts and labor warranty. 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 in accrued expenses a liability for estimated costs that it expects to incur under its basic limited warranties when product revenue is recognized. Factors affecting the Company's 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.

The changes in the Company's product warranty liability during 2006 and 2005 were as follows:

	Year Ended December 31,	
	2006	2005
Liability, beginning of year	$ 150,000	$ 64,000
Expense for new warranties issued	158,000	86,000

Warranty claims	(20,000)	--
Liability, end of year	$ 288,000	$ 150,000

INCOME TAXES

The Company uses the liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, ACCOUNTING FOR INCOME TAXES. Deferred income taxes are recognized based on the differences between financial statement and income tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The provision for income taxes represents the tax payable for the year and the change during the year in deferred tax assets and liabilities.

STOCK-BASED COMPENSATION

On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004), SHARE-BASED PAYMENT, which is a revision of SFAS No. 123. SFAS No. 123R superseded Accounting Principles Board ("APB") Opinion No. 25, and amended SFAS No. 95, STATEMENT OF CASH FLOWS. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS 123. However, SFAS 123R generally requires share-based payments to employees, including grants of employee stock options and purchases under employee stock purchase plans, to be recognized in the statement of operations based on their fair values. Pro forma disclosure of fair value recognition is no longer an alternative. The Company adopted this new standard on January 1, 2006 using the modified prospective method under which compensation cost is recognized beginning with the effective date of adoption (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date of adoption and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of adoption that remain unvested on the date of adoption.

SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under earlier accounting rules. This requirement reduces net operating cash flows and increases net financing cash flows in periods after adoption. Total cash flow remains unchanged from what would have been reported under prior accounting rules.

The actual effects of adopting SFAS No. 123R will depend on numerous factors, including the amounts of share-based payments granted in the future, the valuation model the Company uses to value future share-based payments to employees and estimated forfeiture rates. In 2006, the Company recorded expenses of $131,000 relating to currently outstanding stock options.

EARNINGS PER SHARE

Earnings per share is calculated according to SFAS No. 128, EARNINGS PER SHARE. Basic earnings per share includes no dilution and is computed by dividing

net income available to common stockholders by the weighted average number of shares outstanding during the year. Diluted earnings per share reflects the potential dilution of securities that could share in the earnings of the Company.

FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS, requires all entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value. This statement defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. As of December 31, 2006 and 2005, the fair value of all financial instruments approximated carrying value.

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are reasonable estimates of their fair value because of the short maturity of these items. The Company believes the carrying amounts of its notes payable and long-term debt approximate fair value because the interest rates on these instruments are subject to change with, or approximate, market interest rates.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions 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 amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

CONCENTRATION OF CREDIT RISK

Financial instruments, which potentially expose the Company to concentration of credit risk, consist primarily of cash and accounts receivable. The Company places its cash with high quality financial institutions. At times, cash balances may be in excess of the amounts insured by the Federal Deposit Insurance Corporation.

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 United States, France and U.K. 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 collectibility of all past due accounts. Credit losses are provided for in the financial statements and consistently have been within management's expectations. Sales to Rockwell Collins represented approximately 9% of the Company's total net sales during 2006 and 10% during 2005. No other customer

represented 10% or more of the Company's total net sales during those periods.

FOREIGN CURRENCY TRANSLATION

The accounts of foreign subsidiaries have been translated using the local currency as the functional currency. Accordingly, foreign currency denominated assets and liabilities have been translated to United States dollars at the current rate of exchange on the balance sheet date and at the average for the period reported for the statement of operations. The effects of translation are recorded as a separate component of stockholders' equity in accumulated other comprehensive income (loss). Exchange gains and losses arising from transactions denominated in foreign currencies are translated at the exchange rates applicable on the dates of the transactions and are included in operations.

GOODWILL AND OTHER INTANGIBLE ASSETS

SFAS No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS, disallows the amortization of goodwill and provides for impairment testing of goodwill carrying values on an annual basis or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company performed its annual required tests of impairment as of December 31, 2006, 2005 and 2004 for goodwill in the electronic devices segment and the communications equipment segment reporting units. No events or changes in circumstances occurred between annual tests that would have required an interim goodwill impairment test. Intangible assets with identifiable useful lives are amortized using the straight-line method over their useful lives.

(2) ACQUISITIONS

LARUS CORPORATION ACQUISITION

Pursuant to the terms of a Stock Purchase Agreement executed on July 13, 2004, the Company acquired all of the issued and outstanding common stock of Larus Corporation. Larus Corporation was based in San Jose, California and engaged in the manufacturing and sale of telecommunications products. Larus Corporation had one wholly-owned subsidiary, Vista Labs, Incorporated ("Vista"), which provided engineering services to Larus Corporation. Assets held by Larus Corporation included intellectual property, cash, accounts receivable and inventories owned by each of Larus Corporation and Vista.

The purchase price for the acquisition totaled $6,539,500 and consisted of $1,000,000 in cash, the issuance of 1,213,592 shares of the Company's common stock with a fair value of $1,000,000, $887,500 in the form of two short-term, zero interest promissory notes that were repaid in 2004, $3,000,000 in the form of two subordinated secured promissory notes, warrants to purchase up to an aggregate of 150,000 shares of the Company's common stock at $1.30 per share, which warrants were valued at $72,000, and approximately $580,000 of acquisition costs. In addition, the Company assumed $245,000 in accounts payable and accrued expenses and entered into an above-market real property lease with the sellers.

The lease represented an obligation that exceeded the fair market value by approximately $756,000 and is part of the acquisition accounting. The cash

portion of the acquisition purchase price was funded with proceeds from the Company's prior credit facility with Wells Fargo Bank, N.A. and cash on-hand.

In determining the purchase price for Larus Corporation , the Company took into account the historical and expected earnings and cash flow of Larus Corporation, as well as the value of companies of a size and in an industry similar to Larus Corporation, comparable transactions and the market for such companies generally. The purchase price represented a significant premium over the $1,800,000 recorded net worth of Larus Corporation's assets.

In conjunction with the Company's July 2004 acquisition of Larus Corporation, the Company commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. The results of the study were as follows: Larus trade name and trademark were valued at $750,000, and the technology and customer relationships were valued at $1,350,000. Goodwill associated with the Larus Corporation acquisition totaled $4,321,000. The Larus trade name and trademark were determined to have indefinite lives and therefore are not being amortized but rather are being periodically tested for impairment. The technology and customer relationships were both estimated to have ten-year lives.

The following table summarizes the unaudited assets acquired and liabilities assumed in connection with this acquisition:

	Amount in Thousands
Current assets	$ 2,460
Property, plant and equipment	90
Intangible assets other than goodwill	2,100
Goodwill	4,321
Total assets acquired	8,971
Current liabilities	(450)
Deferred income taxes	(1,093)
Unfavorable lease obligation and other liabilities	(888)
Total liabilities assumed	(2,431)
Net assets acquired	$ 6,540

The intangible assets other than goodwill consist of non-amortizable trade names with a carrying value of $750,000, and technology and customer relationships with carrying values of $1,150,000 and $200,000, respectively, that are amortizable over ten years.

PASCALL ACQUISITION

On March 1, 2005, the Company and EEL, a second-tier wholly-owned subsidiary of the Company, entered into an agreement ("Purchase Agreement") for EMRISE Electronics to acquire all of the issued and outstanding capital stock of Pascall Electronic (Holdings) Limited ("PEHL") from Intelek Properties Limited (which was a subsidiary of Intelek PLC, a London Stock Exchange public limited company). The closing of the purchase occurred on March 18, 2005. The Company loaned to EEL the funds that EEL used to purchase PEHL. PEHL has one wholly-owned subsidiary, Pascall Electronics Limited ("Pascall"), which produces, designs, develops, manufactures and sells power supplies and RF products for a broad range of applications, including in-flight entertainment systems and military programs.

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Under the Purchase Agreement, EEL purchased all of the outstanding capital stock of PEHL, using funds loaned to EEL by the Company. The purchase price for the acquisition totaled $9,905,000, subject to adjustments as described in the Purchase Agreement, and included cash payments totaling $6,208,000 to PEHL's former parent, a $3,082,000 loan to PEHL and Pascall and approximately $615,000 in acquisition costs.

The Company and Intelek PLC have agreed to guarantee payment when due of all amounts payable by EEL and Intelek Properties Limited, respectively, under the Purchase Agreement. The Company and EEL agreed to underwrite the guaranty that Intelek Properties Limited has given to Pascall's landlord with a guaranty by the Company, and EEL has agreed to indemnify Intelek Properties Limited and its affiliates for damages they suffer as a result of any failure to obtain the release of the guarantee of the 17-year lease that commenced in May 1999. The leased property is a 30,000 square foot administration, engineering and manufacturing facility located off the south coast of England.

Intelek Properties Limited has agreed to various restrictive covenants that apply for various periods following the closing. The covenants include non-competition with Pascall's business, noninterference with Pascall's customers and suppliers, and non-solicitation of Pascall's employees. In conjunction with the closing, Intelek Properties Limited, Intelek PLC, EEL, and the Company entered into a Supplemental Agreement dated March 18, 2005. The Supplemental Agreement provides, among other things, that an interest-free bridge loan of 200,000 British pounds sterling (approximately $385,000 based on the exchange rate in effect on March 17, 2005) that was made by the seller to Pascall on March 17, 2005 would be repaid by Pascall by March 31, 2005. EEL agreed to ensure that Pascall had sufficient funds to repay the bridge loan. The bridge loan was repaid in full by Pascall on the March 31, 2005 due date.

The purchase price represented a significant premium over the recorded net worth of Pascall's assets. In conjunction with the acquisition of Pascall, the Company commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. The Company considered whether the acquisition included various types of identifiable intangible assets, including trade names, trademarks, patents, covenants not to compete, customers, workforce, technology and software. The Company has recorded the value of the trade name and trademark at $500,000, covenants not to compete that were obtained from Pascall's former affiliates at $200,000, amortizable over three years and backlog at $200,000 amortizable over two years.

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the unaudited assets acquired and liabilities assumed in connection with this acquisition, including $615,000 in acquisition costs:

	Dollars in Thousands
Current assets	$ 6,196
Property, plant and equipment	1,367
Intangibles, including goodwill	5,534
Total assets acquired	13,097
Current liabilities	(2,863)
Other liabilities	(80)
Total liabilities assumed	(2,943)
Net assets acquired	$ 10,154

RO ACQUISITION

On September 2, 2005, the Company's wholly-owned subsidiary, EMRISE Electronics, entered into a stock purchase agreement dated effective as of August 31, 2005 to acquire RO, a California corporation. Effective September 28, 2005, EMRISE Electronics entered into an amendment to the stock purchase agreement.

Pursuant to the terms of the stock purchase agreement, as amended, EMRISE Electronics acquired all of the issued and outstanding shares of common stock of RO. Prior to the acquisition, all of the common stock of RO was owned by Robert H. Okada as Trustee of the Robert H. Okada Trust Agreement dated February 11, 1992, and Sharon Vavro.

The purchase price consisted of $2,400,000 in cash paid at closing and an additional $600,000 in cash payable in two equal installments on October 6, 2005 and March 31, 2006. The acquisition purchase price was funded with cash on-hand. The purchase price is subject to adjustment based on the value of the stockholders' equity, accounts receivable, accounts payable, cash on hand and net inventory of RO, as determined by the consolidated, unaudited balance sheet as of August 31, 2005, prepared in accordance with accounting principles generally accepted in the United States of America. In addition, concurrently with the closing of the acquisition of RO, EMRISE Electronics paid in full all then existing credit facilities of RO in the aggregate amount of $1,602,000.

In determining the purchase price for RO, EMRISE Electronics considered the historical and expected earnings and cash flow of RO, as well as the value of companies of a size and in an industry similar to RO, comparable transactions and the market for such companies generally. The purchase price represented a premium of approximately $2,275,000 over the $2,340,000 recorded net worth of the assets of RO. In determining this premium, EMRISE Electronics considered the synergistic and strategic advantages provided by having a United States-based power conversion manufacturer and the value of the goodwill, customer relationships and technology of RO. Goodwill associated with the RO acquisition totaled approximately $1,376,000. The Company commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. The valuation study of RO's intangible was completed in June 2006. The Company initially estimated the intangibles to be valued as follows: technology, $484,000, trademarks, $300,000 and customer relationships, $200,000. The valuation study resulted in the following valuations: technology, $500,000, trademarks, $350,000 and customer relationships, $350,000. The intangibles were adjusted to the appraised values in the second quarter of 2006. The technology and customer relationships are being amortized over 10 years on their appraise values and the trademarks are not being amortized due to the inability to determine an estimated life.

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In connection with the execution of the stock purchase agreement, EMRISE Electronics executed a lease agreement with Caspian Associates for the lease of 25,700 square feet of a 30,700 square feet building located at 246 Caspian Drive, Sunnyvale, California (see Note 15).

The following table summarizes the unaudited assets and liabilities assumed in connection with this acquisition, including $65,000 in acquisition costs:

	Dollars in Thousands
Current assets	$ 3,213
Property, plant and equipment	329
Intangibles, including goodwill	2,489
Other assets	66
Total assets acquired	6,097
Current liabilities	(943)
Other liabilities	(522)
Total liabilities assumed	(1,465)
Net assets acquired	$ 4,632

PRO FORMA RESULTS OF OPERATIONS

The following table summarizes, on an unaudited pro forma basis, the combined results of operations of the Company, Larus Corporation, Pascall and RO, as though the Larus Corporation, Pascall and RO acquisitions occurred as of January 1, 2004. The pro forma amounts give effect to appropriate adjustments for interest expense and income taxes. The pro forma amounts presented are not necessarily indicative of future operating results (in thousands, except per share amounts).

	Year Ended December 31,	
	2005	2004
Revenues	$ 47,933	$ 52,767
Net income	$ 1,324	$ 2,072
Earnings per share of common stock:		
Basic	$ 0.04	$ 0.06
Diluted	$ 0.03	$ 0.06

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(3) INVENTORIES, NET

Inventories are summarized as follows as of December 31:

	2006	2005
Raw materials	$ 4,689,000	$ 4,668,000
Work-in-process	3,247,000	2,716,000
Finished goods	2,639,000	2,893,000
	$ 10,575,000	$ 10,277,000

Included in the amounts above are allowances for inventory obsolescence of $5,657,000 and $4,053,000 at December 31, 2006 and 2005, respectively. Allowances for inventory obsolescence are recorded as necessary to reduce obsolete inventory to estimated net realizable value or to specifically reserve for obsolete inventory that the Company intends to dispose of. The inventory items identified for disposal at each year end are generally discarded during the following year.

(4) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following as of December 31:

	2006	2005
Land and buildings	$ 379,000	$ 343,000
Machinery, equipment and fixtures	4,533,000	4,002,000
Leasehold improvements	729,000	663,000
	5,641,000	5,008,000
Accumulated depreciation and amortization	(3,396,000)	(2,935,000)
	$ 2,245,000	$ 2,073,000

Depreciation and amortization expense recorded for property, plant and equipment was $798,000, $654,000 and $247,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

(5) LINES OF CREDIT

Outstanding borrowings under the Company's revolving lines of credit described below were as follows as of December 31:

	2006	2005
Line of credit with a U.S. commercial lender	$ 1,978,000	$ --
Lines of credit with foreign banks	2,332,000	3,283,000
	$ 4,310,000	$ 3,283,000

On August 25, 2005, the Company, together with two subsidiaries, CXR Larus and EMRISE Electronics, acting as guarantors, obtained a credit facility from Wells Fargo Bank, N.A. (the "Bank credit facility") for the Company's United States operations. The Bank credit facility provided a $9,000,000 revolving line of credit secured by accounts receivable, other rights to payment and general intangibles, inventories and equipment, with an interest rate adjusted monthly based on the prime rate.

The Bank credit facility also provided for a term loan of $150,000 secured by equipment, amortizable over 36 months at a variable rate equal to the prime rate plus 1.5% (see Note 6). In addition, Wells Fargo Bank provided the Company with credit for the purchase of new capital equipment when needed, with an interest rate equal to the 90-day London InterBank Offered Rate ("LIBOR") (5.36% at December 31, 2006) plus 3.75% per annum. Amounts borrowed under this arrangement are being amortized over 60 months from the respective dates of borrowing and secured by the purchased equipment (see Note 6).

The Company and Wells Fargo Bank amended the credit facility in November 2005 and March 2006 to revise various covenants and other provisions. On September 19, 2006, the Company entered into a Third Amendment to Credit Agreement effective as of September 1, 2006 with Wells Fargo Bank. The amendment provided for the waiver by Wells Fargo Bank of certain violations of financial covenants. The amendment also provided for the reduction in the amount of the Bank credit facility from $9,000,000 to $1,500,000 and limited borrowings to 80% of eligible accounts receivable. In connection with the amendment, the Company executed a Revolving Line of Credit Note dated September 1, 2006 in the amount of $1,500,000. On October 9, 2006, the Company executed a letter agreement dated effective October 1, 2006 with Wells Fargo Bank extending the maturity date of the $1,500,000 note to October 20, 2006.

On November 13, 2006, Wells Fargo Bank issued a notice of default and demand for payoff with respect to the $1,500,000 note. All obligations under the note were due and payable on November 20, 2006. On November 24, 2006, the Company entered into a Forbearance Agreement with Wells Fargo Bank, dated effective as of November 20, 2006, whereby Wells Fargo Bank agreed to forbear from exercising its rights under the Bank credit facility as described in the notice of default and demand for payoff through December 1, 2006. On December 1, 2006, EMRISE Corporation, EMRISE Electronics, CXR Larus, RO and Wells Fargo Bank acting through its Wells Fargo Business Credit operating division ("WFBC") entered into a Credit and Security Agreement ("WFBC credit facility") providing for a revolving line of credit and term loan. On December 5, 2006, the Company paid off the $1,500,000 Bank credit facility in full.

The WFBC credit facility provides for a $5,000,000 revolving line of credit that expires on December 1, 2009 and is secured by accounts receivable, other rights to payment and general intangibles, inventories and equipment. The line of credit is formula-based and generally provides that the outstanding borrowings under the line of credit may not exceed an aggregate of 85% of eligible accounts receivable plus 10% of the value of eligible finished goods inventory. Interest is payable monthly. The interest rate is variable and is adjusted monthly based on the prime rate plus 1%. The prime rate at December 1, 2006 was 8.25%.

The WFBC credit facility is subject to an unused line fee equal to 0.25% per annum, payable monthly based on the average daily unused amount of the line of credit. The WFBC credit facility is also subject to a minimum monthly interest charge of $8,500 with respect to the revolving line of credit.

The WFBC credit facility is subject to various financial covenants on a consolidated basis as follows. The minimum debt service coverage ratio must be greater than 1.20:1.00 on a trailing quarterly basis. "Debt service coverage ratio" is defined as net income after taxes, plus depreciation, plus amortization, plus or minus changes in deferred taxes, minus capital expenditures and minus any dividends or distributions, divided by the current maturities of long-term debt paid or scheduled to be paid plus any payments on subordinated debt. The WFBC credit facility also requires that the Company maintain a minimum book net worth, determined at the end of each calendar month,

in an amount not less than $26,900,000 for the months ended December 31, 2006, January 31, 2007 and February 28, 2007 and of not less than that amount plus 80% of the Company's net income for each calendar quarter ending on or after March 31, 2007 and for each calendar month ending on or after March 31, 2007. The Company was not permitted to incur a net loss of greater than $1,150,000 for 2006, and for each quarterly period occurring after December 31, 2006, the Company's net income must not be less than $0.

If WFBC terminates the WFBC credit facility during a default period, or if the Company terminates or reduces the WFBC credit facility prior to the maturity date, or if the Company prepays the term loan portion of the facility, the Company will be subject to penalties as follows: if the termination or prepayment occurs during the one year period after the initial funding date, the penalty is equal to 3% of the maximum line amount and/or prepayment amount; if the termination or prepayment occurs during second year after the initial funding date, the penalty is equal to 2% of the maximum line amount and/or prepayment amount; and if the termination or prepayment occurs at any time after the second anniversary of the initial funding date and prior to the maturity date, the penalty is equal to 1% of the maximum line amount and/or prepayment amount.

In the event of a default and continuation of a default, Wells Fargo may accelerate the payment of the principal balance, requiring the Company to pay the entire indebtedness outstanding on that date. From and after the maturity date of the WFBC credit facility, or any earlier date that all principal owing under the WFBC credit facility becomes due and payable by acceleration or otherwise, the outstanding principal balance will bear interest until paid in full at an increased rate per annum equal to 3% above the rate of interest in effect from time to time under the WFBC credit facility.

The WFBC credit facility also provides for a term loan of $200,000 secured by accounts receivable, other rights to payment and general intangibles, inventories and equipment, amortizable over 36 months at a variable rate equal to the prime rate plus 1% (see Note 6).

As of December 31, 2006, the Company had balances of $1,978,000 outstanding on the WFBC revolving line of credit and $200,000 outstanding on the term loan. Availability on the WFBC revolving line of credit was $102,000. As of

December 31, 2006, the Company was not in compliance with the loan's financial covenants for net worth and net losses. The Company obtained a waiver from WFBC for those covenant violations. WFBC is currently in the process of resetting the covenants for 2007.

As of December 31, 2006, the Company's foreign subsidiaries had credit facilities, including lines of credit and term loans, with Lloyds TSB Bank PLC ("Lloyds TSB") and Lloyds TSB Commercial Finance Limited ("Lloyds") in England, IFN Finance, a subsidiary of ABN AMRO Holdings, N.V., Banc National de Paris, Societe Generale in France, and Sogelease and Johnan Shinkin Bank in Japan. At December 31, 2006, the balances outstanding under the Company's United Kingdom, France and Japan credit facilities were $1,762,000, $1,156,000 and $15,000, respectively.

On July 8, 2005, XPS and Pascall obtained a credit facility with Lloyds. At the same time, the credit facility of Venture Finance PLC, a subsidiary of ABN AMRO Holdings, N.V., was terminated, and all debt to Venture Finance PLC was paid off. The Lloyds facility provides a revolving loan secured by receivables, with a maximum availability of 2,100,000 British pounds sterling (approximately $4,114,000 based on the exchange rate in effect on December 31, 2006). The annual interest rate on the revolving loan is 1.5% above the Lloyds TSB base rate. The Lloyds TSB base rate was 5.0% at December 31, 2006. The financial covenants include a 50% cap on combined export gross sales of XPS and Pascall and days sales outstanding of less than 65 days, and the funding balance is capped at 125% of XPS and Pascall combined gross sales. Based on the Company's long-term relationship with Lloyds Bank, the Company anticipates but can give no assurance that it will be able to renew or obtain a new credit facility from Lloyds Bank when this existing facility expires July 31, 2007.

On August 26, 2005, XPS entered into an agreement with Lloyds for an unsecured cashflow loan of 300,000 British pounds sterling (approximately $587,000 based on the exchange rate in effect on December 31, 2006), payable over 12 months. The loan is structured as an overadvance on the previously negotiated 2,100,000 British pounds sterling revolving loan with Lloyds, bringing the maximum aggregate commitment on the revolving loan to 2,400,000 British pounds sterling (approximately $4,700,000 based on the exchange rate in effect on December 31, 2006). The interest rate is variable and is adjusted monthly based on the base rate of Lloyds TSB plus 1.9%. Lloyds TSB has sole discretion to switch the details on this overadvance account if Lloyds determines that the Company will have difficulty in meeting the specific reductions in the overadvance account. The balance on the XPS and Pascall revolving loans at December 31, 2006 was $1,204,000. Availability on the XPS and Pascall revolving loans was $3,015,000 as of December 31, 2006.

On August 26, 2005, EEL, a United Kingdom-based subsidiary of the Company, entered into an agreement with Lloyds TSB for an unsecured term loan of 500,000 British pounds sterling (approximately $979,000 based on the exchange rate in effect on December 31, 2006). This loan is repayable in 36 consecutive monthly installments, representing principal and interest. The interest rate is variable and is adjusted daily based on the Lloyds TSB base rate plus 2.5%. The loan also includes financial covenants. EEL must maintain profit before taxation and interest paid and payable of no less than 150% of interest paid and payable (see Note 6).

In the event of a default, Lloyds may make the loans, including any outstanding principal and interest that has accrued, repayable on demand. If any amount payable is not paid when due, EEL must pay an increased interest rate per annum equal to 3% above the rate of interest in effect from time to time under the note.

In April 2003, CXR-AJ obtained a credit facility from IFN Finance, a subsidiary of ABN AMRO N.V. This credit facility is for a maximum of $1,583,000 based on the exchange rate in effect at December 31, 2006 for the conversion of euros into United States dollars. CXR-AJ also had $28,000 of term loans with another French bank outstanding as of December 31, 2006 (see Note 6). The IFN Finance facility is secured by accounts receivable and carries an annual interest rate of 1.6% above the French "T4M" rate. At December 31, 2006, the French T4M rate was 3.52%, and this facility had a balance of $1,128,000. This facility has no financial performance covenants. Availability on the IFN Finance credit line was $188,000 as of December 31, 2006, in addition to $152,000 availability with several other banks.

XCEL Japan Ltd., or XJL, obtained a term loan on November 29, 2002 from Johnan Shinkin Bank (see Note 6). The loan is amortized over five years, carries an annual fixed interest rate of 3.25% and is secured by the assets of XJL. The balances of the loan as of December 31, 2006 and 2005 were $15,000 and $32,000, respectively, using the exchange rates in effect at those dates for conversion of Japanese yen into United States dollars. There are no financial performance covenants applicable to this loan.

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(6) LONG-TERM DEBT

A summary of long-term debt as of December 31 follows:

	2006	2005
Term notes payable to U.S. commercial lender (a)	$ 200,000	$ 75,000
Term notes payable to foreign banks (b)	601,000	844,000
Capitalized lease and equipment loan obligations (c)	248,000	327,000
	1,049,000	1,246,000
Current portion	(516,000)	(504,000)
	$ 533,000	$ 742,000

(a) The Company's domestic credit facility provides for a term loan of $200,000 secured by equipment, amortizable over 36 months, commencing in January 2007, at a variable rate equal to the prime rate plus 1.0%. The term loan portion of the facility had balances of $200,000 and $75,000 at December 31, 2006 and 2005, respectively.

(b) The Company has agreements with several foreign banks that include term

borrowings that mature at various dates through 2008. Interest rates on the borrowings bear interest at rates ranging from 3.25% to 7% and are payable in monthly installments.

UNITED KINGDOM - The unsecured United Kingdom term loan in the original principal amount of $979,000 is payable over 36 months commencing in September 2005 at $24,000 per month and interest is the base rate plus 2.5%. At December 31, 2006 and 2005, the outstanding balances were $558,000 and $778,000, respectively.

FRANCE - The term loans in France had aggregate balances of $28,000 and $34,000 at December 31, 2006 and 2005, respectively, and are payable over 60 months and secured by the assets of the local subsidiary, bear an annual interest rate of 4% and are not subject to financial performance covenants.

JAPAN - The term loan in Japan is a five-year amortizable loan that commenced in November 2002 and had balances of $15,000 and $32,000 as of December 31, 2006 and 2005, respectively, carries an annual fixed interest rate of 3.25%, is secured by the Japanese subsidiary's assets and is not subject to financial performance covenants.

(c) Capitalized lease obligations totaling $151,000 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. The leases all contain bargain purchase options and expire at various dates through December 31, 2017. The capital equipment loans totaling $97,000 are amortized over five years and bear interest at the bank's 30-day LIBOR plus 4%.

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Principal maturities related to long-term debt, including loans from stockholders (see Note 14), as of December 31, 2006 were as follows:

Year Ending December 31,	Amount
2007	$ 1,016,000
2008	887,000
2009	623,000
2010	264,000
2011	9,000
Total	$ 2,799,000

(7) ACCRUED EXPENSES

Accrued expenses as of December 31 consisted of the following:

	2006	2005
Accrued salaries	$ 717,000	$ 675,000
Accrued payroll taxes and benefits	830,000	735,000
Advance payments from customers	1,840,000	219,000

Other accrued expenses	1,922,000	1,942,000
Total accrued expenses	$ 5,309,000	$ 3,571,000

No other individual item represented more than 5% of total current liabilities.

(8) SHARE-BASED COMPENSATION

On January 1, 2006, the Company adopted the provisions of SFAS No. 123R under the modified prospective method (see Note 1). The Company applied SFAS No. 123R to new awards in 2006 and to any previous awards that were modified, repurchased, or cancelled after the date of adoption of this standard.

At December 31, 2006, a variety of the Company's stock-based compensation grants or awards were outstanding for employees (including officers) and members of the board of directors. All stock-based compensation plans were approved by the Company's board of directors.

DESCRIPTION OF STOCK OPTION PLANS

The Company has four stock option plans:

- Employee Stock and Stock Option Plan, effective July 1, 1994, providing for non-qualified stock options as well as restricted and non-restricted stock awards to both employees and outside consultants. Up to 520,000 shares were authorized for issuance under this plan. Terms of related grants under the plan are at the discretion of the board of directors. The board of directors does not intend to issue any additional options or make any additional stock grants under this plan.

- 1993 Stock Option Plan, providing for the grant of up to 300,000 incentive and non-qualified stock options to purchase stock at not less than the current market value on the date of grant. Options granted under this plan vest ratably over three years and expire 10 years after date of grant. The board of directors does not intend to issue any additional options under this plan.

- The 1997 Stock Incentive Plan (the "1997 Plan") provides that options granted may be either qualified or nonqualified stock options and are required to be granted at fair market value on the date of grant. Subject to termination of employment, options may expire up to ten years from the date of grant and are nontransferable other than in the event of death, disability or certain other transfers that the committee of the board of directors administering the 1997 Plan may permit. Up to 1,600,000 stock options were authorized to be granted under the 1997 Plan. All outstanding options of former optionholders under the XET 1987 Employee Stock Option Plan were converted to options under the 1997 Plan as of the date of the merger between the Company and EMRISE Electronics at the exchange rate of 1.451478. The board of directors

does not intend to issue any additional options under this plan.

- The 2000 Stock Option Plan was adopted by the board of directors in November 2000 and approved by the stockholders on January 16, 2001. The board of directors adopted the Amended and Restated 2000 Stock Option Plan (the "2000 Plan") effective as of August 3, 2001. Under the 2000 Plan, options granted may be either incentive or nonqualified options. Incentive options must have an exercise price of not less than the fair market value of a share of common stock on the date of grant. Nonqualified options must have an exercise price of not less than 85% of the fair market value of a share of common stock on the date of grant. Up to 2,000,000 options may be granted under the 2000 Plan. No option may be exercised more than ten years after the date of grant.

Stock option activity for the years ended December 31, 2006, 2005 and 2004 was as follows:

	2006		2005		
	Shares (thousands)	Weighted Average Exercise Price	Shares (thousands)	Weighted Average Exercise Price	Sha (thou
Outstanding, beginning of year	2,108	$ 1.05	2,133	$ 0.97	
Granted	50	$ 1.00	725	$ 1.92	
Exercised*	(181)	$ 0.54	(106)	$ 0.38	
Forfeited (including expirations)	(12)	$ 3.13	(644)	$ 1.88	
Outstanding at end of year	1,965	$ 1.08	2,108	$ 1.05	
Exercisable, end of year	1,860	$ 1.08	1,908	$ 1.00	

* Exercised at option prices ranging from $0.35 to $1.00 during 2006, from $0.32 to $1.00 during 2005, and from $0.20 to $0.35 during 2004.

The total fair value of options that vested during the years ended December 31, 2006, 2005, and 2004, was approximately $213,000, $738,000, and $127,000, respectively. As of December 31, 2006, the Company had 1,860,000 fully-vested stock options, with a weighted-average exercise price of $1.08 and remaining term of 6.2 years. The Company expects that 105,000 stock options (after forfeitures), with a weighted-average exercise price of $1.17 and remaining term of 8.3 years, will vest in the future. The aggregate intrinsic value is approximately $531,000 for unvested and vested options at December 31, 2006 based on the Company's average common stock closing price in the fourth quarter of 2006.

The Company received $97,000 from the exercise of stock options in 2006. The tax benefit realized was de minimis. For options exercised during the years ended December 31, 2006, 2005, and 2004, the differences between the fair value of the common shares issued and their respective exercise price were approximately $141,000, $144,000, and $19,000, respectively.

If the fair values of the options granted during 2005 and 2004 had been recognized as compensation expense on a straight-line basis over the vesting period of the grant, stock-based compensation costs would have impacted the Company's net income and earnings per common share as follows:

	2005	2004
Net income as reported	$ 1,441,000	$ 1,327,000
Add: Stock-based employee compensation expense included in net loss, net of related tax effects	--	--
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(738,000)	(127,000)
Pro forma net (loss) income	$ 703,000	$ 1,200,000
Earnings per share:		
Basic earnings per share -- as reported	$ 0.04	$ 0.06
Diluted earnings per share -- as reported	$ 0.04	$ 0.05
Basic earnings per share -- pro forma	$ 0.02	$ 0.06
Diluted earnings per share -- pro forma	$ 0.02	$ 0.05

As of December 31, 2006, there was approximately $100,000 in unrealized compensation cost related to non-vested stock options. This expense will be recognized over a weighted average period of 8 years. A summary of the status of the Company's non-vested shares and changes during 2006 follows:

	Shares (thousands)	Weighted-Average Grant-Date Fair Value
Nonvested, beginning of year	200	$ 1.12
Granted	50	1.00
Vested	(145)	1.07
Forfeited (including expirations)	--	--
Nonvested end of year	105	$ 0.96

The estimated fair value of stock options at the time of grant using the Black-Scholes option-pricing model was as follows:

	2006	2005	2004
Fair value per option	$ 0.79	$ 1.02	$ 0.79
Assumptions:			
Annualized dividend yield	0%	0%	0%
Expected volatility	86%	88%	92%
Risk-free interest rate	4.75%	4.25%	3.0%
Expected option term (in years)	7.0	7.0	7.0

Details on various stock option exercise price ranges as of December 31, 2006 are as follows:

	Outstanding Options			Exercisable Options	
Range of Exercise Price	Shares (thousands)	Weighted Average Life (years)	Weighted Average Exercise Price	Shares (thousands)	Weighted Average Exercise Price
$0.20 to $1.00	1,185	5.29	$ 0.56	1,130	$ 0.55
$1.01 to $2.00	780	8.8	1.87	730	1.90
Total options	1,965	6.52	$ 1.08	1,860	$ 1.08

As discussed above, performance-based options granted in 2006 were measured on the date of grant using a Black-Scholes model. The key assumptions used for valuing the performance-based options during 2006 are as follows:

Risk-free interest	4.75%
Expected dividends	0.0%
Expected volatility	86.0%

(9) STOCK ISSUANCE

On January 5, 2005, the Company issued to 17 accredited record holders in a private offering an aggregate of 12,503,500 shares of common stock at a purchase price of $1.44 per share and five-year investor warrants to purchase up to an additional 3,125,875 shares of our common stock at an exercise price of $1.73 per share, for total proceeds of approximately $18,005,000. The Company paid cash placement agent fees and expenses of approximately $961,000, and issued five-year placement warrants to purchase up to an aggregate of 650,310 shares of common stock at an exercise price of $1.73 per share in connection with the offering. The total warrants issued, representing 3,776,185 shares of the Company's common stock, have an estimated value of $4,400,000.

Additional costs related to the financing include registration rights-related liquidated damages of $803,000 (including payments of $44,064 during each of the months of June through November 2006 and a final payment of $102,815 in December 2006 for a total of $323,135 in 2006, in addition to the $480,000 paid in 2005), and legal, accounting and consulting fees that totaled

approximately $505,000 through December 31, 2006. The liquidated damages were charged directly to equity as a return of capital against the gross proceeds of the financing. No further liquidated damages are due.

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company used portions of the proceeds from this financing to fund the acquisitions of Pascall and RO described in Note 2. The Company used the remaining proceeds from this financing primarily for investments in new products and enhancements to existing products.

The Company's board of directors has also authorized the issuance of common stock purchase warrants to certain officers, directors, stockholders, key employees and other parties as follows:

	Number of Shares	Exerci
		Per Share
Balance outstanding at December 31, 2004	806,000	$0.31 to $1.30
Warrants issued	3,886,000	$1.73 to $2.00
Warrants exercised	(205,000)	$0.39 to $0.75
Balance outstanding at December 31, 2005	4,487,000	$0.75 to $2.00
Warrants issued	25,000	$1.21
Warrants exercised	(351,000)	$0.75 to $2.00
Balance outstanding at December 31, 2006	4,161,000	$0.75 to $2.00

During 2006, the Company issued warrants to purchase up to 25,000 shares of common stock at an exercise price of $1.21 per share for services rendered or to be rendered. The estimated value of the warrants was $15,000 and was calculated using the Black-Scholes pricing model with the following assumptions: risk-free interest rate of 4.25%, expected life of 3 years, no dividend yield and an expected volatility of 80%.

(10) INCOME TAXES

The Company files a consolidated United States federal income tax return. This return includes all domestic companies 80% or more owned by the Company. State tax returns are filed on a consolidated, combined or separate basis depending on the applicable laws relating to the Company and its domestic subsidiaries.

Income before income taxes was taxed under the following jurisdictions for the years ended December 31:

2006	2005	2004

Domestic	$ (3,073,000)	$ 25,000	$ 762,000
Foreign	246,000	1,149,000	614,000
Total	$ (2,996,000)	$ 1,174,000	$ 1,376,000

Income tax expense (benefit) consisted of the following for the years ended December 31:

	2006	2005	2004
Current			
Federal	$ --	$ --	$ 34,000
State	36,000	--	52,000
Foreign	548,000	535,000	242,000
Total current	$ 584,000	$ 535,000	$ 328,000

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	2006	2005	2004
Deferred			
Federal	$ 109,000	$ (705,000)	$ (204,000)
State	--	30,000	(11,000)
Foreign	(74,000)	(127,000)	(64,000)
Total deferred	$ 35,000	$ (802,000)	$ (279,000)
Total			
Federal	$ 109,000	$ (705,000)	$ (170,000)
State	36,000	30,000	41,000
Foreign	474,000	408,000	178,000
Total	$ 619,000	$ (267,000)	$ 49,000

Income tax expense (benefit) differed from the amount obtained by applying the statutory federal income tax rate of 34% to income before income taxes as follows for the years ended December 31:

	2006	2005	2004
Tax at U.S. federal statutory rate	$ (1,128,000)	$ 399,000	$ 468,000
State taxes, net of federal income tax benefit	(143,000)	30,000	41,000
Foreign income taxes	(101,000)	(42,000)	248,000
Change in valuation allowances	2,024,000	(607,000)	(179,000)
Permanent differences	(33,000)	(47,000)	(6,000)
Utilization of net operating losses	--	--	(523,000)

Other	--	--	--
	$ 619,000	$ (267,000)	$ 49,000

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities were as follows as of December 31:

	2006	2005
Deferred tax assets:		
Fixed assets depreciation	$ 59,000	$ --
Allowance for doubtful accounts	38,000	44,000
Inventory reserves and uniform capitalization	1,065,000	770,000
Other accrued liabilities	319,000	361,000
Deferred compensation	218,000	118,000
Alternative minimum tax credit carryforwards	142,000	142,000
Capital loss carryforwards	136,000	136,000
Net operating loss carryforwards	5,835,000	4,661,000
Total deferred tax assets	7,812,000	6,232,000
Valuation allowance for deferred tax assets	(7,086,000)	(4,846,000)
Deferred tax assets (current)	$ 726,000	1,386,000

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	2006	2005
Deferred tax liabilities:		
Depreciation	$ --	(51,000)
Intangible assets other than goodwill	(1,053,000)	(1,057,000)
Deferred tax liabilities (long-term)	(1,053,000)	(1,108,000)
Net deferred tax assets (liabilities)	$ (327,000)	$ 278,000

As of December 31, 2006 and 2005, the Company had recorded $726,000 and $1,386,000, respectively, of net deferred tax assets and $1,053,000 and $1,108,000, respectively, of deferred tax liabilities. The Company had federal and state net operating loss carryforwards of approximately $15,459,000 and $14,187,000 as of December 31, 2006 and 2005, respectively, that expire at

various dates through 2023. As of December 31, 2006 and 2005, the Company recorded a valuation allowance on the deferred tax asset. Management believes sufficient uncertainty exists regarding the realizability of the deferred tax asset items and that a valuation allowance is required. Management considers projected future taxable income and tax planning strategies in making this assessment. For the years ended December 31, 2006 and 2005, management recorded increases in its valuation allowances of $1,903,000 and a decrease of $948,000, respectively, based on the domestic book income in 2006 and 2005 and projections for future taxable income over periods that the deferred assets are deductible. Management believes that it is more likely than not that the Company will realize the benefits of its net deferred tax asset. The amount of the deferred tax assets considered realizable, however, could materially change in the near future if estimates of future taxable income during the carryforward period are changed.

As a result of the merger in 1997 of the privately held EMRISE Electronics with a wholly-owned, newly formed subsidiary of the Company, with EMRISE Electronics as the surviving subsidiary, the Company experienced a more than 50% ownership change for federal income tax purposes. As a result, an annual limitation will be placed upon the Company's ability to realize the benefit of a significant portion of its federal net operating loss and credit carryforwards. The Company currently has $9,606,000 of net operating losses not subject to annual limitation, as these losses were generated subsequent to the 50% change in ownership. The remaining net operating loss of $5,835,000 generated before the change in ownership is subject to the annual limitation. Of the $4,581,000 net operating loss carryforward subject to limitation, approximately $276,000 per year is available to offset future federal taxable income.

(11) EARNINGS PER SHARE

The following table illustrates the computation of basic and diluted (loss) earnings per share:

	2006	2005	2004
NUMERATOR:			
Net (loss) income	$ (3,615,000)	$ 1,441,000	$ 1,327,000
(Loss) income attributable to common stockholders	$ (3,615,000)	$ 1,441,000	$ 1,327,000
DENOMINATOR:			
Weighted average number of common shares outstanding during the period - basic	37,981,000	37,256,000	24,063,000
Incremental shares from assumed conversions of warrants, options and preferred stock	--	1,195,000	776,000
Adjusted weighted average shares - diluted	37,981,000	38,448,000	24,839,000
Basic (loss) earnings per share	$ (0.10)	$ 0.04	$ 0.06

Diluted (loss) earnings per share	$ (0.10)	$ 0.04	$ 0.05

The following table shows the common stock equivalents that were outstanding as of December 31, 2006 and 2005 but were not included in the computation of diluted (loss) 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 be anti-dilutive:

	Number of Shares	Exercise Price Per Share
Anti-dilutive common stock options:		
As of December 31, 2006	780,000	$1.13 to $2.00
As of December 31, 2005	686,000	$2.00
Anti-dilutive common stock warrants:		
As of December 31, 2006	4,111,000	$1.30 to $2.00
As of December 31, 2005	3,886,000	$1.73 to $2.00

(12) COMMITMENTS AND CONTINGENCIES

LEASES

The Company conducts most of its operations from leased facilities under operating leases that expire at various dates through 2013. The leases generally require the Company to pay all maintenance, insurance and property tax costs and contain provisions for rent increases. Total rent expense, net of sublease income, for 2006, 2005 and 2004 was approximately $1,549,000, $885,000 and $1,070,000, respectively.

The future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year (including the related party lease discussed in Note 14) are as follows:

Year Ending December 31,	Amount
2007	$ 1,648,000
2008	1,257,000
2009	1,078,000
2010	962,000
2011	241,000
2012 and thereafter	--
Total	$ 5,186,000

LITIGATION

The Company is not currently a party to any material legal proceedings. However, the Company and its subsidiaries are, from time to time, involved in legal proceedings, claims and litigation arising in the ordinary course of

business. While the amounts claimed may be substantial, the ultimate liability cannot presently be determined because of considerable uncertainties that exist. Therefore, it is possible the outcome of such legal proceedings, claims and litigation could have a material effect on quarterly or annual operating results or cash flows when resolved in a future period. However, based on facts currently available, management believes such matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

EMPLOYEE BENEFIT PLANS

Effective October 1, 1998, the Company instituted a defined contribution plan ("401(k) Plan") covering the majority of its United States domestic employees. Participants may make voluntary pretax contributions to such plans up to the limit as permitted by law. Company contributions to the 401(k) plan are discretionary. The Company made contributions of $34,000, $36,000 and $25,000 to the 401(k) Plan for the years ended December 31, 2006, 2005 and 2004, respectively.

The Company's subsidiary in France has a defined benefit pension plan. The plan is an unfunded plan. As of the December 31, 2006 and 2005 measurement dates, the status of the defined benefit pension plan was as follows:

	2006	2005
Projected benefit obligation	$ 208,000	$ 163,000
Fair value of plan assets	$ --	$ --
Unfunded accumulated benefit	$ 192,000	$ 155,000
Accumulated benefit obligation	$ 208,000	$ 163,000
Employer contributions	$ --	$ --
Participant contributions	$ --	$ --
Benefits paid	$ --	$ 18,000

Contributions to be paid to the plan during the year ended December 31, 2006 are estimated to be none.

Weighted average assumptions used to determine pension benefit obligations at December 31, 2006 and 2005 were as follows:

	2006	2005
Discount rate	4.00%	4.50%
Expected return on plan assets	4.25%	4.00%
Rate of compensation increase	2.00%	--

The components of the net periodic pension costs for the years ended December 31, 2006 and 2005 were as follows:

	2006	2005
Service cost	$ 11,000	$ 11,000
Interest cost	7,000	7,000
Expected return on plan assets	--	--

Amortization of transition asset, prior service cost and actuarial loss	--	--
Net periodic benefit cost	$ 18,000	$ 18,000

The following table sets forth the changes in benefit obligation for the years ended December 31, 2006 and 2005:

	2006	2005
Change in benefit obligations:		
Benefit obligation at beginning of year	$ 163,000	$ 122,000
Service cost	11,000	11,000
Interest cost	7,000	7,000
Benefits paid	--	18,000
Contributions	--	--
Effect of foreign currency translation	27,000	5,000
Benefit obligation at end of year	$ 208,000	$ 163,000

EXECUTIVE MANAGEMENT

Effective January 1, 2001, the Company and Carmine T. Oliva, its Chief Executive Officer, entered into an employment agreement that provided for an annual base salary of $250,000, with annual merit increases, an initial term of five years, two renewal periods of two years each, and severance pay of at least three years' salary during the initial period or at least two years' salary during a renewal period. On February 24, 2006, the Company and Mr. Oliva entered into a new five-year employment agreement effective as of January 1, 2006. The new employment agreement provides for an annual base salary of $350,000 and severance of three times his annual base salary, net of taxes, under certain circumstances.

Effective July 2, 2001, the Company and Randolph D. Foote, its Senior Vice President, Chief Financial Officer and Secretary, entered into an employment agreement that provides for an initial annual salary of $130,000, an initial term of three years, two renewal periods of one year each, and severance pay of at least one years' salary. On February 24, 2006, the Company and Mr. Foote entered into a new two-year employment agreement effective as of January 1, 2006. The new employment agreement provided for an annual base salary of $175,000 and severance of one and one-half times his annual base salary, net of taxes, under certain circumstances.

On August 18, 2006, Mr. Foote resigned from all positions with the Company and its subsidiaries. The Company entered into a Resignation and Separation Agreement with Mr. Foote, which became effective on August 25, 2006. Under the agreement, Mr. Foote resigned all of his positions with the Company, and the Company and Mr. Foote jointly terminated his employment agreement dated effective as of January 1, 2006. The agreement provides that effective as of August 21, 2006, Mr. Foote will be assigned to temporary employment with the

Company, which the parties anticipated would terminate by approximately December 31, 2006.

On December 31, 2006, the Company and Mr. Foote amended the separation agreement to extend Mr. Foote's temporary employment to no later than March 30, 2007. The Company and Mr. Foote intend to amend the separation agreement to extend Mr. Foote's temporary employment to no later than April 30, 2007. During the time of his temporary employment, Mr. Foote has been assisting the Company in, among other things, the preparation of the Company's restated financial statements and various filings with the Commission and has continued to receive his base salary and employment benefits (other than paid vacation benefits, bonus or incentive compensation). Mr. Foote's stock options are scheduled to terminate three months after termination of his temporary employment. For twelve months following termination of his temporary employment, Mr. Foote has agreed to continue to provide reasonable cooperation and assistance to the Company as needed, and subject to Mr. Foote's performance of his obligations under the separation agreement, the Company has agreed to pay to Mr. Foote in installments on the Company's regular pay dates during that period the total gross amount of $182,200 and to reimburse Mr. Foote for health plan benefit premiums at the same benefit level he had as of his resignation date.

Effective July 2, 2001, the Company and Graham Jefferies, Managing Director of EEL and Executive Vice President and Chief Operating Officer of the Company, entered into an employment agreement that provides for an initial annual salary of 100,000 British pounds sterling (approximately $141,000 at the then current exchange rates), an initial term of three years, two renewal periods of one year each, and severance pay of at least one years' salary. On February 24, 2006, the Company and Mr. Jefferies entered into a new three-year employment agreement effective as of January 1, 2006. The new employment agreement provides for an annual base salary of 152,800 British pounds sterling per year (approximately $263,350 as of January 1, 2006) and severance of twice his annual base salary, net of taxes, under certain circumstances.

(13) SEGMENT AND MAJOR CUSTOMER INFORMATION

The Company has two reportable segments: electronic devices and communications equipment. The electronic devices segment operates in the United States, European and Asian markets and designs, manufactures and markets digital switches and power supplies. The communications equipment segment operates principally in the United States and European markets and designs, manufactures and distributes voice and data transmission and networking equipment and communications test instruments.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based upon profit or loss from operations before income taxes exclusive of nonrecurring gains and losses. The Company accounts for intersegment sales at prices negotiated between the individual segments.

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's reportable segments are comprised of operating entities offering the same or similar products to similar customers. Each segment is managed separately because each business has different customers and different design and manufacturing and marketing strategies.

Each segment has business units or components as described in paragraph 30 of SFAS No. 142. Each component has discrete financial information and a management structure. Following is a description of the Company's segment and component structure as of December 31, 2006:

REPORTING UNITS WITHIN ELECTRONIC DEVICES SEGMENT:

- EMRISE Electronics - Rancho Cucamonga, California: Digitran Division - digital and rotary switches, and electronic subsystem assemblies for defense and aerospace applications and keypads
- EMRISE Electronics - Monrovia, California: XCEL Circuits Division - printed circuit boards mostly for intercompany sales
- RO - Sunnyvale, California: manufacturer of standard power supplies using proprietary technology.
- XCEL Japan Ltd. - Tokyo, Japan: Reseller of Digitran switches and other third party electronic components
- EEL - Ashford, Kent, England: Power supplies and conversion for defense and aerospace applications; this reporting unit also includes XPS and Pascall.

REPORTING UNITS WITHIN COMMUNICATIONS EQUIPMENT SEGMENT:

- CXR Telcom division of CXR Larus Corporation - San Jose, California: Telecommunications test equipment for the field and central office applications
- Larus division of CXR Larus Corporation - San Jose, California: Telecommunications synchronous timing devices and network access equipment
- CXR-Anderson Jacobson - Abondant, France: network access and modem equipment

As described in Note 2, the Company acquired PEHL and Pascall in March 2005. These two entities are being included in EEL reporting unit of the electronic devices segment.

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Selected financial data for each of the Company's operating segments is shown below.

	2006	2005	2004
SALES TO EXTERNAL CUSTOMERS			
Electronic devices	$ 32,702,000	$ 25,687,000	$ 15,262,000
Communications equipment	13,682,000	15,583,000	14,375,000
Total	$ 46,384,000	$ 41,270,000	$ 29,637,000

INTEREST EXPENSE			
Electronic devices	$ 172,000	$ 181,000	$ 180,000
Communications equipment	318,000	274,000	250,000
Total	$ 490,000	$ 455,000	$ 430,000
DEPRECIATION AND AMORTIZATION			
Electronic devices	$ 922,000	$ 674,000	$ 91,000
Communications equipment	232,000	241,000	126,000
Total	$ 1,154,000	$ 915,000	$ 217,000
SEGMENT PROFITS BEFORE INCOME TAX			
Electronic devices	$ 2,730,000	$ 3,191,000	$ 2,612,000
Communications equipment	(1,368,000)	697,000	1,580,000
Total	$ 1,362,000	$ 3,888,000	$ 4,192,000
SEGMENT ASSETS			
Electronic devices	$ 27,514,000	$ 25,144,000	$ 8,435,000
Communications equipment	15,912,000	16,358,000	16,371,000
Total	$ 43,426,000	$ 41,502,000	$ 24,806,000

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

GOODWILL AND OTHER INTANGIBLE ASSETS BY SEGMENT AS OF DECEMBER 31, 2006

	Goodwill -- Not Amortizable	Trademarks and Trade Names -- Not Amortizable	Technology Acquired -- 10-Year Life Amortizable	Customer Relation-ships -- 10-Year Life Amortizable	Covena Not to Compe 3-Year Amortiz
GROSS COST					
Electronic devices	$ 7,379,000	$ 850,000	$ 500,000	$ 350,000	$ 200
Communications equipment	6,706,000	750,000	1,150,000	200,000	
Total	$ 14,085,000	$ 1,600,000	$ 1,650,000	$ 550,000	$ 200
ACCUMULATED AMORTIZATION					
Electronic devices	$ 218,000	$ --	$ 67,000	$ 47,000	$ 117
Communications equipment	872,000	--	287,000	50,000	
Total	$ 1,090,000	$ --	$ 354,000	$ 97,000	$ 117

CARRYING VALUE					
Electronic devices	$ 7,161,000	$ 850,000	$ 433,000	$ 303,000	$ 83
Communications equipment	5,834,000	750,000	863,000	150,000	
Total	$ 12,995,000	$ 1,600,000	$ 1,296,000	$ 453,000	$ 83

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

GOODWILL AND OTHER INTANGIBLE ASSETS BY SEGMENT AS OF DECEMBER 31, 2005

	Goodwill -- Not Amortizable	Trademarks and Trade Names -- Not Amortizable	Technology Acquired -- 10-Year Life Amortizable	Customer Relation- ships -- 10-Year Life Amortizable	Covena Not to Compe 3-Year Amortiz
GROSS COST					
Electronic devices	$ 6,702,000	$ 813,000	$ 484,000	$ 200,000	$ 200
Communications equipment	6,428,000	750,000	1,150,000	200,000	
Total	$ 13,130,000	$ 1,563,000	$ 1,634,000	$ 400,000	$ 200
ACCUMULATED AMORTIZATION					
Electronic devices	$ 192,000	$ --	$ 16,000	$ 7,000	$ 50
Communications equipment	872,000	--	172,000	30,000	
Total	$ 1,064,000	$ --	$ 188,000	$ 37,000	$ 50
CARRYING VALUE					
Electronic devices	$ 6,510,000	$ 813,000	$ 468,000	$ 193,000	$ 150
Communications equipment	5,556,000	750,000	978,000	170,000	
Total	$ 12,066,000	$ 1,563,000	$ 1,446,000	$ 363,000	$ 150

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CHANGES IN GOODWILL BY SEGMENT

	Electronic	Commun

	Devices	Equipment	To
Balance at January 1, 2005	$ 1,085,000	$ 4,796,000	$ 5,
Goodwill acquired or reclassed from other intangibles	5,930,000	760,000	6,
Impairment	--	--	
Foreign currency translation	(505,000)	--	(
Balance December 31, 2005	$ 6,510,000	$ 5,556,000	$ 12,
Balance at January 1, 2006	$ 6,510,000	$ 5,556,000	$ 12,
Goodwill acquired	--	--	
Acquisition allocation adjustment	(157,000)	278,000	
Foreign currency translation	808,000	--	
Balance December 31, 2006	$ 7,161,000	$ 5,834,000	$ 12,

The Company's future aggregate amortization expense for intangibles for the next five years is as follows:

Year Ending December 31,	Amount
2007	$ 312,000
2008	$ 237,000
2009	$ 220,000
2010	$ 220,000
2011	$ 220,000

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a reconciliation of the reportable segment revenues, profit or loss and assets to the Company's consolidated totals.

	2006	2005	2004
NET SALES			
Total sales for reportable segments	$ 46,384,000	$ 41,270,000	$ 29,637,000
Elimination of intersegment sales	--	--	--
Total consolidated net sales	$ 46,384,000	$ 41,270,000	$ 29,637,000
(LOSS) INCOME BEFORE INCOME TAXES			
Total (loss) income for reportable segments	$ 1,362,000	$ 3,888,000	$ 4,192,000
Unallocated amounts:			

General corporate expenses	(4,358,000)	(2,714,000)	(2,816,000)
Consolidated (loss) income before income taxes	$ (2,996,000)	$ 1,174,000	$ 1,376,000
ASSETS			
Total assets for reportable segments	$ 43,426,000	$ 41,502,000	$ 24,806,000
Other assets	1,359,000	2,959,000	338,000
Total consolidated assets	$ 44,785,000	$ 44,461,000	$ 25,144,000
INTEREST EXPENSE			
Interest expense for reportable segments	$ 490,000	$ 455,000	$ 430,000
Other interest expense	--	--	3,000
Total interest expense	$ 490,000	$ 455,000	$ 433,000
DEPRECIATION AND AMORTIZATION			
Depreciation and amortization expense for reportable segments	$ 1,154,000	$ 915,000	$ 217,000
Other depreciation and amortization expense	36,000	49,000	70,000
Total depreciation and amortization	$ 1,190,000	$ 964,000	$ 287,000

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the Company's net sales and identifiable assets by geographical area follows:

	2006	2005	2004
NET SALES:			
United States	$ 16,952,000	$ 15,957,000	$ 12,521,000
Japan	1,186,000	1,271,000	935,000
France	7,120,000	6,657,000	7,016,000
United Kingdom	21,126,000	17,385,000	9,165,000
	$ 46,384,000	$ 41,270,000	$ 29,637,000
LONG-LIVED ASSETS:			
United States	$ 765,000	$ 734,000	$ 440,000
Japan	7,000	7,000	11,000
France	90,000	101,000	142,000
United Kingdom	1,376,000	1,231,000	316,000
	$ 2,245,000	$ 2,073,000	$ 909,000

Sales and purchases between geographic areas have been accounted for on the basis of prices set between the geographic areas, generally at cost plus 40%. Identifiable assets by geographic area are those assets that are used in

the Company's operations in each location. Net sales by geographic area have been determined based upon the country from which the product was shipped.

No customer in the electronic devices segment accounted for 10% or more of net sales during 2006 and one customer accounted for 10% or more of net sales during 2005 and 2004.

(14) QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a summary of the quarterly operations for the years ended December 31, 2006 and 2005 (in thousands, except for per share data).

	2006		
	Mar. 31	June 30	Sept. 30
Net sales	$ 10,734	$ 10,817	$ 12,177
Gross profit	$ 4,384	$ 3,792	$ 4,678
Net loss	$ (322)	$ (1,010)	$ (716
Loss applicable to common stockholders	$ (322)	$ (1,010)	$ (716
Loss per share:			
Basic and diluted	$ (0.01)	$ (0.03)	$ (0.02

	2005		
	Mar. 31	June 30	Sept. 30
Net sales	$ 7,523	$ 9,962	$ 11,177
Gross profit	$ 3,278	$ 3,963	$ 4,866
Net (loss) income	$ (197)	$ 21	$ 816
(Loss) income (applicable) available to common stockholders	$ (197)	$ 21	$ 816
(Loss) earnings per share:			
Basic	$ (0.01)	$ 0.02	$ 0.02
Diluted	$ (0.01)	$ 0.00	$ 0.02

EMRISE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(15) RELATED PARTY TRANSACTIONS

On July 13, 2004, the Company issued two promissory notes to the former stockholders of Larus Corporation totaling $3,000,000 in addition to paying cash and issuing shares of common stock and two zero interest short-term notes totaling $887,500 that were repaid in 2004, in exchange for 100% of the common stock of Larus Corporation (see Note 2). These notes are subordinated to the Company's bank debt and are payable in 72 equal monthly payments of principal totaling $41,667 per month plus interest at the 30-day LIBOR plus 5% with a maximum interest rate of 7% during the first two years of the term of the notes,

8% during the third and fourth years, and 9% thereafter. At December 31, 2006, the 30-day LIBOR was 5.3279%.

Future maturities of notes payable to stockholders are as follows:

Year Ending December 31,	
2007	$ 500,000
2008	500,000
2009	500,000
2010	250,000
2011	--
	$ 1,750,000

Interest paid on these notes in 2006 and 2005 was $152,000 and $179,000, respectively.

The Company entered into an above-market real property lease with the sellers. The lease represented an obligation that exceeded the fair market value by approximately $756,000. The lease term is for 7 years and expires on June 30, 2011. It is renewable for a 5-year term priced under market conditions. The base rent is based on a minimum rent of $.90 per square foot per month, which is $27,000 monthly or $324,000 per year, subject to monthly adjustments of the interest rate based on the Federal Reserve Discount Rate that match the lessor's variable interest rate mortgage payments on the building. The maximum increase in any year is 1.5%, with a cumulative maximum increase of 8% over the life of the lease. The increases apply to that portion of the rent that corresponds to the interest portion of the lessor's mortgage. Lease payments paid to the related parties during 2006 and 2005 totaled $456,000 and $378,000, respectively. Future minimum lease payments under the operating lease payable to the stockholders are included in Note 11.

The Company entered into a lease for the RO building with Caspian Associates ("Caspian"), a California general partnership. Richard Okada, who was President of RO prior to the Company's acquisition and is currently the President of RO, is a general partner of Caspian. The lease provided for a two-year term commencing on September 1, 2005 and ending on August 31, 2007, at a base rent of $9,210 per month. Additionally, the lease provided for an extension of the lease term for an additional three years, to August 31, 2010, and a rent increase if RO achieves certain net sales and cumulative gross profit targets. However, the targets were eliminated from the lease when the property was sold on November 1, 2006. Also, on March 1, 2007, the lease converted into a month-to-month tenancy where either party may provide the other with 30 days' notice to terminate the lease. As of December 31, 2006, the lease obligation was $12,280 per month, which was more than the original $9,210 because a sublessee terminated its sublease in May 2006. The Company paid $138,000 and $37,000 on the lease in 2006 and 2005, respectively. The Company terminated the lease on March 31, 2007.

There are no guarantees by officers or fees paid to officers or loans to or from officers.

See Note 11 for information regarding employment arrangements with the Company's executive management.

(16) NEW ACCOUNTING PRONOUNCEMENTS

The Company adopted SFAS No. 123R on January 1, 2006 (see Note 1).

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, INVENTORY COSTS, AN AMENDMENT OF ARB NO. 43, CHAPTER 4. SFAS No. 151 clarifies that abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage) are required to be recognized as current period costs. The provisions of SFAS No. 151 are effective for 2006. The Company is currently evaluating the provisions of SFAS No. 151 and does not expect that adoption will have a material effect on its financial position, results of operations or cash flows.

On December 16, 2004, the FASB issued SFAS No. 153, EXCHANGES OF NONMONETARY ASSETS, AN AMENDMENT OF APB OPINION NO. 29, ACCOUNTING FOR NONMONETARY TRANSACTIONS. SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for nonmonetary asset exchanges beginning in the second quarter of 2006. The Company does not believe its adoption of SFAS No. 153 will have a material effect on its consolidated financial position, results of operations or cash flows.

On June 7, 2005, the FASB issued SFAS No. 154, ACCOUNTING CHANGES AND ERROR CORRECTIONS, a replacement of APB Opinion No. 20, ACCOUNTING CHANGES, and SFAS No. 3, REPORTING ACCOUNTING CHANGES IN INTERIM FINANCIAL STATEMENTS. SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition of a cumulative effect adjustment within net income of the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. However, SFAS No. 154 does not change the transition provisions of any existing accounting pronouncements. The Company does not believe its adoption of SFAS No. 154 will have a material effect on its consolidated financial position, results of operations or cash flows.

In February 2006, the FASB issued SFAS No. 155, ACCOUNTING FOR CERTAIN HYBRID FINANCIAL INSTRUMENTS, which amends SFAS No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES and SFAS No. 140, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS. Specifically, SFAS No. 155 amends SFAS No. 133 to permit fair value remeasurement for any hybrid financial instrument with an embedded derivative that otherwise would require bifurcation, provided the whole instrument is accounted for on a fair value basis. Additionally, SFAS No. 155 amends SFAS No. 140 to allow a qualifying special purpose entity to hold a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 applies to all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006, with early application allowed. The Company does not expect that the adoption of SFAS No. 155 will have a material effect on its results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, FAIR VALUE MEASUREMENTS. This new statement provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS No. 157 also emphasizes that

fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. The required effective date of SFAS No. 157 is the first quarter of 2008. The Company currently is evaluating the effect this statement may have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES. SFAS No. 159 permits an entity to irrevocably elect fair value on a contract-by-contract basis as the initial and subsequent measurement attribute for many financial assets and liabilities and certain other items including insurance contracts. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense up front cost and fees associated with the item for which the fair value option is elected. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157, FAIR VALUE MEASUREMENTS. The Company is currently evaluating the effect that adoption of SFAS No. 159 would have on its financial condition or results of operations.

In June 2006, the FASB issued Financial Interpretation No. 48, ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES--AN INTERPRETATION OF FASB STATEMENT NO. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. The interpretation also provides guidance on derecognition, classification, interest and penalties, and other matters. These provisions are effective for the Company beginning in the first quarter of 2007. The Company currently is assessing the effect of this statement and currently does not believe that adoption will have a material effect on its consolidated financial statements.

On June 29, 2005, the FASB ratified Emerging Issues Task Force ("EITF") Issue No. 05-06, DETERMINING THE AMORTIZATION PERIOD FOR LEASEHOLD IMPROVEMENTS. EITF Issue No. 05-06 provides that the amortization period used for leasehold improvements acquired in a business combination or purchased after the inception of a lease shall be the shorter of (a) the useful life of the assets or (b) a term that includes required lease periods and renewals that are reasonably assured upon the acquisition or the purchase. The provisions of EITF Issue No. 05-06 are effective on a prospective basis for leasehold improvements purchased or acquired beginning in the Company's second quarter of 2005. The Company does not believe its adoption of EITF Issue No. 05-06 will have a material effect on its consolidated financial position, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission ("Commission") issued Staff Accounting Bulletin ("SAB") No. 108, Topic 1N, FINANCIAL STATEMENTS - CONSIDERING THE EFFECTS OF PRIOR YEAR MISSTATEMENTS WHEN QUANTIFYING

MISSTATEMENTS IN THE CURRENT YEAR FINANCIAL STATEMENTS. SAB No. 108 addresses how to quantify the effect of an error on the financial statements and requires a dual approach to compute the materiality of the misstatement. Specifically, the amount of the misstatement is to be computed using both the "rollover" (that is, the current year income statement perspective) and the "iron curtain" (that is, the year-end balance sheet perspective). SAB No. 108 is effective for all fiscal years ending after November 15, 2006. Accordingly, the Company adopted SAB No. 108 in the fourth quarter of 2006. The adoption of SAB No. 108 did not have a material effect on the Company's financial condition or results of operations.

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at Beginning of Year	Additions Charged to Costs and Expenses	Deductions Write-offs of Accounts	Reserve Acquired with Acquisition	
Allowance for doubtful accounts:					
Year ended December 31, 2006	$ 379,000	$ 69,000	$ (57,000)	$ --	$
Year ended December 31, 2005	$ 153,000	$ 151,000	$ (33,000)	$ 108,000	$
Year ended December 31, 2004	$ 161,000	$ --	$ (32,000)	$ 24,000	$
Allowance for inventory obsolescence:					
Year ended December 31, 2006	$ 4,053,000	$ 1,771,000	$ (167,000)	$ --	$
Year ended December 31, 2005	$ 2,251,000	$ 1,403,000	$ (1,150,000)	$ 1,549,000	$
Year ended December 31, 2004	$ 1,692,000	$ 1,116,000	$ (557,000)	$ --	$

INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
2.1	Stock Purchase Agreement dated July 13, 2004 between MicroTel International Inc.; Noel C. McDermott; Warren P. Yost; Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995; and Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (1)
2.2	Agreement dated March 1, 2005 among Intelek Properties Limited, XCEL Corporation Limited, Intelek PLC and EMRISE Corporation relating to the sale and purchase of the outstanding capital shares of Pascall Electronic (Holdings) Limited (13)
2.3	Supplemental Agreement dated March 18, 2005 among Intelek Properties Limited, XCEL Corporation Limited, Intelek PLC and EMRISE Corporation (13)

2.4	Loan Agreement dated March 18, 2005 among XCEL Corporation Limited, Pascall Electronics Limited and Pascall Electronic (Holdings) Limited (13)
2.5	Stock Purchase Agreement dated September 2, 2005 between EMRISE Electronics Corporation, a New Jersey corporation, Robert H. Okada, as Trustee of the Robert H. Okada Trust Agreement dated February 11, 1992, and Sharon Vavro, an individual (16)
2.6	Amendment No. 1 dated effective as of September 28, 2005 to Stock Purchase Agreement dated September 2, 2005 between EMRISE Electronics Corporation, a New Jersey corporation, Robert H. Okada, as Trustee of the Robert H. Okada Trust Agreement dated February 11, 1992, and Sharon Vavro, an individual (17)
3.1	Amended and Restated Certificate of Incorporation of EMRISE Corporation filed with the Secretary of State of Delaware on May 9, 2005 (14)
3.2	Amended and Restated Bylaws adopted by the Board of Directors of the Corporation on September 1, 2004 (3)
10.1	1993 Stock Option Plan (#) (5)
10.2	Employee Stock and Stock Option Plan (#) (6)
10.3	1997 Stock Incentive Plan (#) (7)
10.4	Amended and Restated 2000 Stock Option Plan (#) (9)
10.5	Form of Executive Officer and Director Indemnification Agreement entered into between the Registrant and each of Carmine T. Oliva, Laurence P. Finnegan, Jr., Otis W. Baskin, Richard E. Mahmarian, Randolph D. Foote and Graham Jefferies (2)
10.6	Description of Compensation of Directors (#) (20)
10.7	Credit Facility Agreement dated April 8, 2003, between IFN Finance and CXR, S.A.S. (11)
10.8	English Summary of Credit Facility Agreement dated April 8, 2003 between IFN Finance and CXR, S.A.S. (12)
10.9	Subordinated Secured Promissory Note dated July 13, 2004 in the principal amount of $1,681,318.68 made by MicroTel International Inc. in favor of Noel C. McDermott Revocable Living Trust dated December 19, 1995 (10)
10.10	Subordinated Secured Promissory Note dated July 13, 2004 in the principal amount of $1,318,681.32 made by MicroTel International Inc. in favor of Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)

EXHIBIT NUMBER	DESCRIPTION
10.11	Pledge and Security Agreement dated July 13, 2004 between MicroTel International Inc.; Noel C. McDermott, as Collateral Agent; Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995; and Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)
10.12	Intercreditor Agreement dated July 13, 2004 between MicroTel International Inc.; Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995; and Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)
10.13	Continuing Guarantee dated July 13, 2004 made by Larus Corporation in favor of Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995, and

	Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)
10.14	Continuing Guarantee dated July 13, 2004 made by Vista Labs Incorporated in favor of Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995, and Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)
10.15	Continuing Guarantee dated July 13, 2004 made by CXR Telcom in favor of Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995, and Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)
10.16	Security Agreement dated July 13, 2004 made by Larus Corporation in favor of Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995, and Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)
10.17	Security Agreement dated July 13, 2004 made by Vista Labs Incorporated in favor of Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995, and Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)
10.18	Security Agreement dated July 13, 2004 made by CXR Telcom in favor of Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995, and Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (10)
10.19	Lease agreement between the Registrant and Property Reserve Inc. dated September 16, 1999 (8)
10.20	Lease agreement between XET, Inc. and Rancho Cucamonga Development dated August 30, 1999 (8)
10.21	Commercial Lease dated July 13, 2004 between the Registrant, as Tenant, and Noel C. McDermott and Warren P. Yost, as Landlord, for the premises located at 894 Faulstich Court, San Jose, California (10)
10.22	Executive Employment Agreement dated February 24, 2006 by and between the Registrant and Carmine T. Oliva (#) (19)

EXHIBIT NUMBER	DESCRIPTION
10.23	Executive Employment Agreement dated February 24, 2006 by and between the Company and Graham Jefferies (#) (19)
10.24	Executive Employment Agreement dated February 24, 2006 by and between the Registrant and Randolph D. Foote (#) (19)
10.25	Resignation and Separation Agreement dated August 18, 2006 by and between EMRISE Corporation and Randolph D. Foote (4)
10.26	Consulting Extension Letter Agreement dated December 31, 2006 by and between EMRISE Corporation and Randolph D. Foote
10.27	Loan Agreement dated March 18, 2005 among XCEL Corporation Limited, Pascall Electronics Limited and Pascall Electronic (Holdings) Limited (13)
10.28	Form of Incentive Stock Option Agreement Under Amended and Restated 2000 Stock Option Plan (#) (15)
10.29	Form of Non-Qualified Stock Option Agreement Under Amended and Restated 2000 Stock Option Plan (#) (15)

10.30	Credit Agreement between EMRISE Corporation and Wells Fargo Bank, National Association dated as of August 25, 2005 (18)
10.31	First Amendment to Credit Agreement dated as of November 17, 2005 by and between EMRISE Corporation and Wells Fargo Bank, N.A.(20)
10.32	Second Amendment to Credit Agreement dated as of March 28, 2006 by and between EMRISE Corporation and Wells Fargo Bank, N.A. *
10.33	Third Amendment to Credit Agreement entered into as of September 1, 2006 by and between EMRISE Corporation and Wells Fargo Bank, N.A. (21)
10.34	Revolving Line of Credit Note dated September 1, 2006 made by EMRISE Corporation in favor of Wells Fargo Bank (21)
10.35	Letter Agreement dated October 1, 2006 by and between EMRISE Corporation and Wells Fargo Bank, N.A. (22)
10.36	Forbearance Agreement dated as of November 20, 2006 between EMRISE Corporation and Wells Fargo Bank, N.A. (23)
10.37	Credit and Security Agreement dated December 1, 2006 between EMRISE Corporation, EMRISE Electronics Corporation, CXR Larus Corporation, RO Associates Incorporated and Wells Fargo Bank, N.A. through its Wells Fargo Business Credit operating division (23)
10.38	Revolving Note dated December 1, 2006 executed by EMRISE Corporation, EMRISE Electronics Corporation, CXR Larus Corporation and RO Associates Incorporated in favor of Wells Fargo Bank, N.A. through its Wells Fargo Business Credit operating division (23)
10.39	Term Note dated December 1, 2006 executed by EMRISE Corporation, EMRISE Electronics Corporation, CXR Larus Corporation and RO Associates Incorporated in favor of Wells Fargo Bank, N.A. through its Wells Fargo Business Credit operating division (23)

EXHIBIT NUMBER	DESCRIPTION
10.40	Patent and Trademark Security Agreement dated December 1, 2006 between EMRISE Corporation and Wells Fargo Bank, N.A. through its Wells Fargo Business Credit operating division (23)
10.41	Patent and Trademark Security Agreement dated December 1, 2006 between RO Associates Incorporated and Wells Fargo Bank, N.A. through its Wells Fargo Business Credit operating division (23)
10.42	Debt Purchase Agreement between Lloyds TSB Commercial Finance Limited and Pascall Electronics Limited dated June 28, 2005 (18)
10.43	Debt Purchase Agreement between Lloyds TSB Commercial Finance Limited and XCEL Power Systems Limited dated June 28, 2005 (18)
10.44	Loan Agreement between Lloyds TSB Commercial Finance Limited and XCEL Power Systems Limited dated June 28, 2005 (18)
10.45	Business Loan Agreement between Lloyds TSB Bank PLC and XCEL Corporation Limited dated June 30, 2005 (18)
10.46	Guaranty and Indemnity between XCEL Power Systems Limited, Pascall Electronics Limited, Pascall Electronic (Holdings) Limited, Belix Wound Components Limited and Lloyds TSB Commercial Finance Limited dated June 21, 2005 (18)
10.47	Deed of Guaranty and Indemnity between XCEL Corporation Limited and Lloyds TSB Commercial Finance Limited dated June 21, 2005 (18)
10.48	Deed of Guarantee and Indemnity between Pascall Electronics Limited and Lloyds TSB Commercial Finance Limited dated June 21,

	2005 (18)
10.49	Deed of Guarantee and Indemnity between XCEL Corporation Limited and Lloyds TSB Commercial Finance Limited dated June 21, 2005 (18)
10.50	Deed of Priorities between Lloyds TSB Commercial Finance Limited and Lloyds TSB Bank PLC and Pascall Electronics Limited dated June 28, 2005 (18)
10.51	Deed of Priorities between Lloyds TSB Commercial Finance Limited and Lloyds TSB Bank PLC and XCEL Power Systems Limited dated June 28, 2005 (18)
10.52	All Assets Debenture given by XCEL Power Systems Limited in favor of Lloyds TSB Commercial Finance Limited dated June 28, 2005 (18)
14.1	Amended and Restated Code of Business Conduct and Ethics (20)
14.2	Code of Business Ethics for CEO and Senior Financial Officers (20)
16	Letter dated April 19, 2006 from Grant Thornton LLP regarding change in certifying accountant (24)
21	Subsidiaries of the Registrant (20)

EXHIBIT NUMBER	DESCRIPTION
23	Consent of Hein & Associates LLP, Independent Registered Public Accounting Firm *
31.1	Certification of Principal Executive Officer Required by Rule 13a-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) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *

----

* Filed herewith.

(#) Management contract or compensatory plan, contract or arrangement required to be filed as an exhibit.

(1) Filed as an exhibit to the Registrant's current report on Form 8-K for July 13, 2004 and incorporated herein by reference.

(2) Filed as an exhibit to the Registrant's current report on Form 8-K for December 8, 2004 and incorporated herein by reference.

(3) Filed as Appendix G to the Registrant's definitive proxy statement for the Registrant's 2004 annual meeting of stockholders and incorporated herein by reference.

(4) Filed as an exhibit to the Registrant's Form 8-K for August 16, 2006 and incorporated herein by reference.

(5) Filed as an exhibit to the Registrant's annual report on Form 10-K for the year ended December 31, 2000 and incorporated herein by reference.

(6) Filed as an exhibit to the Registrant's definitive proxy statement for the

Registrant's annual meeting of stockholders held June 11, 1998 and incorporated herein by reference.

(7) Filed as an exhibit to the Registrant's definitive proxy statement for the special meeting of stockholders held January 16, 2001 and incorporated herein by reference.

(8) Filed as an exhibit to the Registrant's interim report on Form 10-Q for September 30, 1999 and incorporated herein by reference.

(9) Filed as an exhibit to the Registrant's quarterly report on Form 10-Q for September 30, 2001 and incorporated herein by reference.

(10) Filed as an exhibit to the Registrant's quarterly report on Form 10-Q for June 30, 2004 and incorporated herein by reference.

(11) Filed as an exhibit to the Registrant's quarterly report on Form 10-Q for June 30, 2003 and incorporated herein by reference.

(12) Filed as an exhibit to amendment no. 1 to the Registrant's quarterly report on Form 10-Q for June 30, 2003 and incorporated herein by reference.

(13) Filed as an exhibit to the Registrant's current report on Form 8-K for March 18, 2005 and incorporated herein by reference.

(14) Filed on May 19, 2005 as an exhibit to the Registrant's current report on Form 8-K for May 6, 2005 and incorporated herein by reference.

(15) Filed as an exhibit to the Registrant's annual report on Form 10-K for the year ended December 31, 2004 and incorporated herein by reference.

(16) Filed as an exhibit to the Registrant's current report on Form 8-K for September 2, 2005 and incorporated herein by reference.

(17) Filed as an exhibit to amendment no. 1 to the Registrant's current report on Form 8-K for September 2, 2005 and incorporated herein by reference.

(18) Filed as an exhibit to the Registrant's quarterly report on Form 10-Q for September 30, 2005 and incorporated herein by reference.

(19) Filed as an exhibit to the Registrant's Form 8-K for February 24, 2006 and incorporated herein by reference.

(20) Filed as an exhibit to the Registrant's annual report on Form 10-K for the year ended December 31, 2005.

(21) Filed as an exhibit to the Registrant's Form 8-K for September 19, 2006 and incorporated herein by reference.

(22) Filed as an exhibit to the Registrant's Form 8-K for October 9, 2006 and incorporated herein by reference.

(23) Filed as an exhibit to the Registrant's Form 8-K for November 24, 2006 and incorporated herein by reference.

(24) Filed as an exhibit to the Registrant's Form 8-K for April 13, 2006 and incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on this 2nd day of April, 2007.

EMRISE CORPORATION

By: /s/ Carmine T. Oliva

Carmine T. Oliva
Chairman of the Board, President, Chief Executive Officer, Acting Chief Financial Officer and Secretary

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

SIGNATURE	CAPACITY	DATE
/s/ Carmine T. Oliva Carmine T. Oliva	Chairman of the Board, President, Chief Executive Officer (principal executive officer), Acting Chief Financial Officer (principal accounting and financial officer), Secretary and Director	April 2, 2007
/s/ Laurence P. Finnegan, Jr. Laurence P. Finnegan, Jr.	Director	April 2, 2007
/s/ Otis W. Baskin Otis W. Baskin	Director	April 2, 2007
/s/ Richard E. Mahmarian Richard E. Mahmarian	Director	April 2, 2007

EXHIBITS ATTACHED TO THIS REPORT

EXHIBIT NUMBER	DESCRIPTION
10.26	Consulting Extension Letter Agreement dated December 31, 2006 by and between EMRISE Corporation and Randolph D. Foote
10.32	Second Amendment to Credit Agreement dated as of March 28, 2006 by and between EMRISE Corporation and Wells Fargo Bank, N.A.
23	Consent of Hein & Associates LLP, Independent Registered Public Accounting Firm
31.1	Certification of Principal Executive Officer required by Rule 13a-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) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002