Emrise CORP
Form S-1/A
April 12, 2005

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON APRIL 12, 2005
REGISTRATION NO. 333-122394

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 1 TO
FORM S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

EMRISE CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	3825	77-0226211
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(PRIMARY STANDARD INDUSTRIAL CLASSIFICATION CODE NUMBER)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

9485 HAVEN AVENUE, SUITE 100
RANCHO CUCAMONGA, CALIFORNIA 91730
(909) 987-9220
(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER,
INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

CARMINE T. OLIVA
PRESIDENT AND CHIEF EXECUTIVE OFFICER
EMRISE CORPORATION
9485 HAVEN AVENUE, SUITE 100
RANCHO CUCAMONGA, CALIFORNIA 91730
(909) 987-9220
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(NAME, ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER,
INCLUDING AREA CODE, OF AGENT FOR SERVICE)

COPIES OF ALL CORRESPONDENCE TO:
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APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC:
As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box. [X]

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. [ ]

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered(1)	Proposed maximum offering price per share(2)	Proposed ma aggrega offering pr
Common stock, $0.0033 par value	18,388,777(3)	$1.49	$27,399,27

(1) In the event of a stock split, stock dividend or similar transaction involving common stock of the registrant, in order to prevent dilution, the number of shares registered shall be automatically increased to cover the additional shares in accordance with Rule 416(a) under the Securities Act.
(2) The proposed maximum offering price per share has been estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) of the Securities Act and is based upon the average of the high and low sale prices of the registrant's common stock reported on the OTC Bulletin Board on January 25, 2005.
(3) Includes 4,606,685 shares of common stock issuable upon exercise of warrants.
(4) Fee of $3,224.89 was paid with the initial filing of this registration statement.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

SUBJECT TO COMPLETION, DATED APRIL 12, 2005

PROSPECTUS

18,388,777 SHARES

EMRISE CORPORATION

COMMON STOCK

This a public offering of 18,388,777 shares of our common stock. All

shares are being offered by selling security holders identified in this prospectus. We will not receive any of the proceeds from the sale of shares by the selling security holders. Our common stock is quoted on the OTC Bulletin Board under the symbol "EMRI." On April 8, 2005, the closing sale price of our common stock on the OTC Bulletin Board was $1.33 per share.

The mailing address and the telephone number of our principal executive offices are 9485 Haven Avenue, Rancho Cucamonga, California 91730, (909) 987-9220.

Investing in our shares of common stock involves risks. See "Risk Factors" beginning on page 6 for factors you should consider before buying shares of our common stock.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES, AND WE ARE NOT SOLICITING OFFERS TO BUY THESE SECURITIES, IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS ACCURATE OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THE DATE OF THIS PROSPECTUS IS _______________, 2005.

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PROSPECTUS SUMMARY

TO FULLY UNDERSTAND THIS OFFERING AND ITS CONSEQUENCES TO YOU, YOU SHOULD READ THE FOLLOWING SUMMARY ALONG WITH THE MORE DETAILED INFORMATION AND OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE NOTES TO THOSE STATEMENTS APPEARING ELSEWHERE IN THIS PROSPECTUS. IN THIS PROSPECTUS, THE WORDS "WE," "US," "OUR" AND SIMILAR TERMS REFER TO EMRISE CORPORATION TOGETHER WITH ITS SUBSIDIARIES UNLESS THE CONTEXT PROVIDES OTHERWISE.

EMRISE CORPORATION

We are a Delaware corporation that was formed July 14, 1989. We have three wholly-owned operating subsidiaries, XET Corporation, a New Jersey corporation that was formed in 1983, 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"). XET Corporation and its subsidiaries design, develop, manufacture and market electronic components 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 manufactures and sells communication timing and synchronization products.

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 the prospectus, we acquired Larus Corporation and Vista Labs, Incorporated in July 2004.

In March 2005, XCEL Corporation Ltd., a United Kingdom-based subsidiary of XET Corporation, acquired Pascall Electronic (Holdings) Limited and its wholly-owned subsidiary, Pascall Electronics Limited ("Pascall"). Pascall is based in the United Kingdom and manufactures a range of proprietary power systems and radio frequency ("RF") components and subsystems.

Through our operating subsidiaries, CXR Larus, CXR-AJ and XET Corporation, 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 Components
    - digital and rotary switches
    - electronic power supplies
    - RF components
    - subsystem assemblies
- 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 components segment, primarily to defense and aerospace customers, defense contractors and industrial customers, were 51.1%, 63.4% and 59.1% of our total net sales for the years 2004, 2003 and 2002, respectively. Sales of communications equipment and related services, primarily to private telecommunications network customers and public carriers, were 48.9%, 36.6% and 40.9% of our total net sales during the years 2004, 2003 and 2002, respectively.

Our objective in our electronic components business is to become the supplier of choice for harsh environment digital and rotary switches, custom power supplies and RF and microwave products. 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.

CORPORATE INFORMATION

Our principal executive offices are located at 9485 Haven Avenue, Suite 100, Rancho Cucamonga, California 91730. Our telephone number is (909) 987-9220. Our Internet address is http://www.emrise.com. Information contained on, or that is accessible through, our websites should not be considered to be part of this prospectus.

THE OFFERING

Common stock offered by the selling security holders	18,388,777 shares
Common stock to be outstanding after this offering	41,991,393 shares
Use of proceeds	All proceeds of this offering will be received by selling security holders for their own accounts. See "Use of Proceeds."
OTC Bulletin Board symbol	EMRI

The number of shares of common stock being offered by the selling security holders includes 13,782,092 outstanding shares of common stock held by certain security holders and assumes the exercise of warrants whose underlying shares of common stock are covered by this prospectus in exchange for 4,606,685 shares of common stock, and the immediate resale of all of those 4,606,685 shares of common stock.

The number of shares of common stock that will be outstanding upon the completion of this offering is based on the 37,384,708 shares outstanding as of March 22, 2005, and excludes the following:

- o 2,327,696 shares of common stock reserved for issuance under our stock option plans, of which options to purchase 1,458,998 shares

were outstanding as of that date, at a weighted average exercise price of $0.64 per share;

- 85,000 shares of common stock underlying warrants outstanding as of that date, at an exercise price of $1.86 per share; and

- any additional shares of common stock we may issue from time to time after that date.

You should read the discussion under "Management -- Stock Option Plans" for additional information about our stock option plans.

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SUMMARY CONSOLIDATED HISTORICAL FINANCIAL DATA

The following financial data should be read in conjunction with the consolidated financial statements and the notes to those statements beginning on page F-1 of this prospectus, and the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus. The consolidated statements of operations and comprehensive income data for the years ended December 31, 2004, 2003 and 2002 and the consolidated balance sheet data at December 31, 2004 and 2003 are derived from the consolidated audited financial statements included in this prospectus. The consolidated statements of operations and comprehensive income data with respect to the years ended December 31, 2001 and 2000 and the consolidated balance sheet data at December 31, 2001 are derived from our audited financial statements not included in this prospectus. The historical results that appear below are not necessarily indicative of results to be expected for any future periods.

	YEAR ENDED DECEMBER 31,			
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME DATA:	2004	2003	2002	2001
	(IN THOUSANDS, EXCEPT PER SHARE			
Net sales	$ 29,861	$ 25,519	$ 22,664	$ 27,423
Cost of sales	16,146	14,835	14,147	15,456
Gross profit	13,715	10,684	8,517	11,967
Selling, general and administrative expenses	10,226	7,812	7,731	10,129
Engineering and product development expenses	1,521	951	1,015	1,076
Income (loss) from operations	1,968	1,921	(229)	762
Total other income (expense)	(439)	(474)	(361)	(414)
Income (loss) from continuing operations before income taxes	1,529	1,447	(590)	348
Income tax (benefit) expense	49	286	(20)	77
Income (loss) from continuing operations	1,480	1,161	(570)	271
Discontinued operations:				
Loss from operations of discontinued segment	--	--	--	56

Gain (loss) on disposal of discontinued segment including provision for phase out period of $122 in 2000	--	--	--	--
Net income (loss)	1,480	1,161	(570)	327
Foreign currency translation adjustment	379	705	446	(312)
Total comprehensive income (loss)	$ 1,859	$ 1,866	$ (124)	$ 15
Basic earnings (loss) per share from continuing operations	$ 0.06	$ 0.05	$ (0.03)	$ 0.01
Diluted earnings (loss) per share from continuing operations	$ 0.06	$ 0.05	$ (0.03)	$ 0.01
Basic earnings (loss) per share from discontinued operations	$ --	$ --	$ --	$ --
Diluted earnings (loss) per share from discontinued operations	$ --	$ --	$ --	$ --
Basic earnings (loss) per share	$ 0.06	$ 0.05	$ (0.03)	$ 0.02
Diluted earnings (loss) per share	$ 0.06	$ 0.05	$ (0.03)	$ 0.01
Weighted average shares outstanding, basic	24,063	22,567	21,208	20,594
Weighted average shares outstanding, diluted	24,839	23,811	21,208	23,782

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CONSOLIDATED BALANCE SHEET DATA:	AT DECEMBER 31, 2004	2003	2002	2001	2000
			(IN THOUSANDS)		
Cash and cash equivalents	$ 1,057	$ 1,174	$ 254	$ 604	$ 756
Working capital	5,540	5,696	3,961	3,686	2,780
Total assets	25,086	17,169	16,786	17,688	19,484
Long-term debt, net of current portion	985	819	927	763	282
Stockholders' equity	10,909	7,916	5,732	5,862	5,807
Convertible redeemable preferred stock	--	--	282	270	259

No cash dividends on our common stock were declared during any of the periods presented above. In October 2000, we decided to discontinue our circuits segment's operations. Accordingly, all current and prior financial information related to the circuits segment operations have been presented as discontinued operations in historical financial data 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, changes in foreign currency conversion rates and new accounting pronouncements that may affect the consistency in the

generally accepted accounting principles that we use. The year ended December 31, 2004 includes five months of Larus Corporation activity. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Overview."

RISK FACTORS

THE FOLLOWING SUMMARIZES MATERIAL RISKS THAT YOU SHOULD CAREFULLY CONSIDER BEFORE YOU DECIDE TO BUY OUR COMMON STOCK IN THIS OFFERING. 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 YOU COULD LOSE THE MONEY YOU PAID TO BUY OUR COMMON STOCK.

RISKS RELATED TO OUR BUSINESS

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

During 2004, the sale of electronic components accounted for 51.1% of our total net sales, and the sale of communications equipment and related services accounted for 48.9% of our total net sales. In many cases we have long-term contracts with our electronic components 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 a reduced demand for our products that could result from a general economic downturn, from changes in the electronic components 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.

RECENTLY ENACTED AND PROPOSED CHANGES IN SECURITIES LAWS AND REGULATIONS WILL INCREASE OUR COSTS.

The Sarbanes-Oxley Act of 2002 has required changes in some of our corporate governance, securities disclosure and compliance practices. As part of the Act's requirements, the Securities and Exchange Commission has promulgated new rules on a variety of subjects, in addition to other rule proposals. These developments have increased and will continue to increase our accounting and legal compliance costs, and could also expose us to additional liability. In addition, these developments may make retention and recruitment of qualified persons to serve on our board of directors or executive management more difficult. We continue to evaluate and monitor regulatory and legislative developments and cannot reliably estimate the timing or magnitude of all costs we may incur as a result of the Act or other related legislation or regulation.

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 COMPONENTS 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 components 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, Graham Jefferies, our Executive Vice President and Chief Operating Officer, and Randolph Foote, our Senior Vice President, Chief Financial Officer and Secretary. Mr. Oliva co-founded XET Corporation 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. We rely upon Mr. Foote's skills in financial reporting, accounting and tax matters in addition to his skills in the analysis of potential acquisitions and general corporate administration. Consequently, the loss of Mr. Oliva, Mr. Jefferies, Mr. Foote 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, 2004, we had $7,720,000 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 components 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 components 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 United States Federal Communications Commission, or FCC, and Underwriters Laboratories as well as industry standards established by Telcordia Technologies, Inc., formerly Bellcore, and the American National Standards Institute. 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. 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 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 57.3% of our net sales for 2004. However, because historically the majority of our currency exposure has related to financial statement translation rather than to particular transactions, we do not intend to enter into, nor have we historically entered into, forward currency contracts or hedging arrangements in an effort to mitigate our currency exposure.

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.

RISKS RELATED TO THIS OFFERING

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. In fact, during 2004, the high and low closing sale prices of a share of our common stock were $1.68 and $0.52, respectively. Between January 1, 2005 and April 8, 2005, the high and low closing sale prices of a share of our common stock were $1.83 and $1.33, 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 components 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.

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. Fluctuations in our operating results may result from a variety of factors. Our operating results from our communications segment tend to be less stable and predictable than our operating results from our electronic components segment.

For example, the general decline in telecommunications market activity and other changes affecting the telecommunications industry, including consolidations and restructuring of United States and foreign telephone companies, cause our sales to decrease or increase. Our sales may increase if we obtain new customers as a result of the consolidations or restructurings. However, our sales may decrease, either temporarily or permanently to the extent our customers are acquired by or combined with companies that are and choose to remain customers of our competitors.

In addition, the cyclical nature of the telecommunications business due to the budgetary cycle of Regional Bell Operating Companies, or RBOCs, has had and will continue to have for the foreseeable future an effect on our quarterly operating results. RBOCs generally obtain approval for their annual budgets during the first quarter of each calendar year. If an RBOC'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 RBOC during the period of the delay or shortfall.

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.

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 22, 2005, we had outstanding 37,384,708 shares of common stock. An aggregate of 13,782,092 of these shares were included for resale under this prospectus. As of March 22, 2005, we also had outstanding options and warrants to purchase up to 6,150,683 shares of common stock. Of these, 4,606,685 shares of common stock underlying warrants were included for resale under this prospectus and 1,458,998 shares underlying options were covered on existing registration statements. Sales of

shares of our common stock in the public market after the registration statement of which this prospectus is a part is declared effective, 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 shares or perceptions.

BECAUSE WE ARE SUBJECT TO THE "PENNY STOCK" RULES, THE LEVEL OF TRADING ACTIVITY IN OUR COMMON STOCK MAY BE REDUCED.

Broker-dealer practices in connection with transactions in "penny stocks" are regulated by penny stock rules adopted by the Securities and Exchange Commission. Penny stocks, like shares of our common stock, generally are equity securities with a price of less than $5.00 per share that trade on the OTC Bulletin Board or the Pink Sheets. The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and, if the broker-dealer is the sole market maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market, and monthly account statements showing the market value of each penny stock held in the customer's account. In addition, broker-dealers who sell these securities to persons other than established customers and "accredited investors" must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These requirements may have the effect of reducing the level of trading activity in a penny stock, such as our common stock, and investors in our common stock may find it difficult to sell their shares.

BECAUSE OUR COMMON STOCK IS NOT LISTED ON A NATIONAL SECURITIES EXCHANGE, YOU MAY FIND IT DIFFICULT TO DISPOSE OF OR OBTAIN QUOTATIONS FOR OUR COMMON STOCK.

Our common stock trades under the symbol "EMRI" on the OTC Bulletin Board. Because our common stock trades on the OTC Bulletin Board rather than on a national securities exchange, you may find it difficult to either dispose of, or to obtain quotations as to the price of, our common stock.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements, including statements concerning future conditions in the electronic components and communications equipment industries, and concerning our future business, financial condition, operating strategies, and operational and legal risks. We use words like "believe," "expect," "may," "will," "could," "seek," "estimate," "continue," "anticipate," "intend," "goal," "future," "plan" or variations of those terms and other similar expressions, including their use in the negative, to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which speak only as to our expectations as of the date of this prospectus. These forward-looking statements are subject to a number of risks and uncertainties, including those identified under "Risk Factors" and elsewhere in this prospectus. Although we believe that the expectations reflected in these forward-looking statements are reasonable, actual conditions in the electronic components and communications equipment industries, and actual conditions and results in our business, could differ

materially from those expressed in these forward-looking statements. In addition, none of the events anticipated in the forward-looking statements may actually occur. Any of these different outcomes could cause the price of our common stock to decline substantially. Except as required by law, we undertake no duty to update any forward-looking statement after the date of this prospectus, either to conform any statement to reflect actual results or to reflect the occurrence of unanticipated events.

USE OF PROCEEDS

We will not receive any of the proceeds from the sale of shares of our common stock in this offering. Rather, all proceeds will be received by selling security holders.

DIVIDEND POLICY

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. In addition, our credit facility with Wells Fargo Bank, N.A., described in "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources," restricts the payment of dividends without the bank's consent.

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.

PRICE RANGE OF COMMON STOCK

Our common stock has been traded on the OTC Bulletin Board under the symbol "EMRI" since September 15, 2004. Throughout 2003 and until September 14, 2004, our common stock traded on the OTC Bulletin Board under the symbol "MCTL." The table below shows, for each fiscal quarter indicated, the high and low closing bid prices for shares of our common stock. This information has been obtained from the OTC Bulletin Board. 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, 2003		
First Quarter	$0.20	$0.15
Second Quarter	0.37	0.20
Third Quarter	1.00	0.28
Fourth Quarter	1.37	0.85
YEAR ENDED DECEMBER 31, 2004		
First Quarter	$1.18	$0.87
Second Quarter	1.28	0.76
Third Quarter	0.82	0.52
Fourth Quarter	1.68	0.60
YEAR ENDING DECEMBER 31, 2005		
First Quarter	$1.82	$1.46

As of March 22, 2005, we had 37,384,708 shares of common stock

outstanding held of record by approximately 2,900 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 April 8, 2005, the closing sale price of our common stock on the OTC Bulletin Board was $1.33 per share.

CAPITALIZATION

The following table sets forth our capitalization as of December 31, 2004 and as adjusted to reflect our issuance of 103,750 shares of common stock upon exercise of options through March 22, 2005, our sale of 12,503,500 shares of common stock on January 5, 2005, and the application of the net proceeds after deducting placement agent fees and estimated offering expenses. The information in the table below should be read in conjunction with our consolidated audited financial statements and related notes beginning on page F-1 of this prospectus. The following table excludes the following shares:

- 3,001,954 and 2,327,696 shares of common stock reserved for issuance under our stock option plans as of December 31, 2004 and March 22, 2005, respectively, of which options to purchase 2,133,256 and 1,458,998 shares were outstanding as of those respective dates, at weighted average exercise prices of $0.97 and $0.64 per share, respectively; and

- 805,000 and 4,691,685 shares of common stock reserved for issuance under outstanding warrants to purchase shares of common stock as of December 31, 2004 and March 22, 2005, respectively, at a weighted average exercise prices of $0.87 and $1.57 per share, respectively.

	DECEMBER 31, 2004	
	ACTUAL	AS ADJUSTED
	(IN THOUSANDS, EXCEPT SHARE DATA) (UNAUDITED)	
Long-term debt, less current portion	$ 985	$ 985
Note payable to stockholders, less current portion	2,250	2,250
Stockholders' equity:		
Preferred Stock, $0.01 par value per share, 10,000,000 shares authorized; no shares issued and outstanding	--	--
Common Stock, $0.0033 par value, 50,000,000 shares authorized; 24,777,458 shares issued and outstanding, actual; and 37,384,708 shares issued and outstanding, as adjusted	82	123
Additional paid-in capital	26,746	43,663
Accumulated deficit	(16,406)	(16,406)
Accumulated other comprehensive loss	487	487
Total stockholders' equity	10,909	27,867

Total capitalization	$ 14,144	$ 31,102

SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA

The following financial data should be read in conjunction with the consolidated financial statements and the notes to those statements beginning on page F-1 of this prospectus, and the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus. The consolidated statements of operations and comprehensive income data for the years ended December 31, 2004, 2003 and 2002 and the consolidated balance sheet data at December 31, 2004 and 2003 are derived from, and are the consolidated audited financial statements included in this prospectus. The consolidated statements of operations and comprehensive income data with respect to the years ended December 31, 2001 and 2000 and the consolidated balance sheet data at December 31, 2001 are derived from, and are our audited financial statements not included in this prospectus. The historical results that appear below are not necessarily indicative of results to be expected for any future periods.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME DATA:	YEAR ENDED DECEMBER 31,			
	2004	2003	2002	2001
	(IN THOUSANDS, EXCEPT PER SHARE			
Net sales	$ 29,861	$ 25,519	$ 22,664	$ 27,423
Cost of sales	16,146	14,835	14,147	15,456
Gross profit	13,715	10,684	8,517	11,967
Selling, general and administrative expenses	10,226	7,812	7,731	10,129
Engineering and product development expenses	1,521	951	1,015	1,076
Income (loss) from operations	1,968	1,921	(229)	762
Total other income (expense)	(439)	(474)	(361)	(414)
Income (loss) from continuing operations before income taxes	1,529	1,447	(590)	348
Income tax expense (benefit)	49	286	(20)	77
Income (loss) from continuing operations	1,480	1,161	(570)	271
Discontinued operations:				
Loss from operations of discontinued segment	--	--	--	56
Gain (loss) on disposal of discontinued segment including provision for phase out period of $122 in 2000	--	--	--	--
Net income (loss)	1,480	1,161	(570)	327
Foreign currency translation adjustment	379	705	446	(312)
Total comprehensive income (loss)	$ 1,859	$ 1,866	$ (124)	$ 15

Basic earnings (loss) per share from continuing operations	$ 0.06	$ 0.05	$ (0.03)	$ 0.01
Diluted earnings (loss) per share from continuing operations	$ 0.06	$ 0.05	$ (0.03)	$ 0.01
Basic earnings (loss) per share from discontinued operations	$ --	$ --	$ --	$ --
Diluted earnings (loss) per share from discontinued operations	$ --	$ --	$ --	$ --
Basic earnings (loss) per share	$ 0.06	$ 0.05	$ (0.03)	$ 0.02
Diluted earnings (loss) per share	$ 0.06	$ 0.05	$ (0.03)	$ 0.01
Weighted average shares outstanding, basic	24,063	22,567	21,208	20,594
Weighted average shares outstanding, diluted	24,839	23,811	21,208	23,782

	AT DECEMBER 31,				
CONSOLIDATED BALANCE SHEET DATA:	2004	2003	2002	2001	2000
			(IN THOUSANDS)		
Cash and cash equivalents	$ 1,057	$ 1,174	$ 254	$ 604	$ 756
Working capital	5,540	5,696	3,961	3,686	2,780
Total assets	25,086	17,169	16,786	17,688	19,484
Long-term debt, net of current portion	985	819	927	763	282
Stockholders' equity	10,909	7,916	5,732	5,862	5,807
Convertible redeemable preferred stock	--	--	282	270	259

No cash dividends on our common stock were declared during any of the periods presented above. In October 2000, we decided to discontinue our circuits segment's operations. Accordingly, all current and prior financial information related to the circuits segment operations have been presented as discontinued operations in historical financial data 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, changes in foreign currency conversion rates and new accounting pronouncements that may affect the consistency in the generally accepted accounting principles that we use. The year ended December 31, 2004 includes five months of Larus Corporation activity. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Overview."

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

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH OUR CONSOLIDATED AUDITED FINANCIAL STATEMENTS AND THE RELATED NOTES AND THE OTHER FINANCIAL INFORMATION INCLUDED ELSEWHERE IN THIS PROSPECTUS. THIS DISCUSSION CONTAINS FORWARD-LOOKING STATEMENTS REGARDING THE ELECTRONIC COMPONENTS 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 PROSPECTUS.

OVERVIEW

Through our three wholly-owned operating subsidiaries, XET Corporation, CXR Larus (formerly, CXR Telcom Corporation) 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 Components
  - digital and rotary switches
  - electronic power supplies
  - RF components
  - subsystem assemblies
- Communications Equipment
  - network access and transmission products
  - communication timing and synchronization products
  - communications test instruments

Sales to customers in the electronic components segment, primarily to aerospace customers, defense contractors and industrial customers, were 51.1%, 63.4% and 59.1% of our total net sales during 2004, 2003 and 2002, respectively. Sales of communications equipment and related services, primarily to private customer premises and public carrier customers, were 48.9%, 36.6% and 40.9% of our total net sales during 2004, 2003 and 2002, respectively.

During 2004, we achieved a 56.1% sales increase in our communications equipment segment as compared to 2003. Excluding sales of $3,424,000 from the business previously conducted by Larus Corporation, which we acquired in July 2004, our communications equipment sales increased 19.5% in 2004 as compared to 2003. Sales of our electronic components segment during 2004 decreased 5.6% as compared to 2003. As discussed below, our improved sales, cost reductions and Asian outsourcing have reduced the breakeven point in our communications equipment segment, which enabled us to produce an improved operating profit in this segment despite the historically low sales volume that reflects a four-year downturn in the telecommunications market. Of our subsidiaries, CXR Larus was the most affected by the telecommunications downturn, because CXR Larus had the greatest dependence on sales to RBOCs.

In 2004, our communications equipment segment sales increased significantly from 2003 due to improved sales of test instruments and our acquisition of Larus Corporation as discussed below. We worked to improve the growth and performance of our communications equipment business, particularly customer premises network access and transmission products. These efforts included our acquisition of Larus Corporation. We expect this acquisition to enhance our performance based upon synergies described below that we achieved through the merger of Larus Corporation with and into CXR Telcom Corporation in December 2004. In connection with the merger, we changed the name of CXR Telcom Corporation to CXR Larus Corporation.

During 2003, CXR-AJ reduced costs by approximately $393,000 annually through compensation reductions due to terminations of employees and a $155,000 reduction in employee benefits, both mainly due to the retirement of the Managing Director of CXR-AJ and the elimination of $45,000 in travel expenses that previously were incurred annually by the retired Managing Director of CXR-AJ and others in connection with marketing activities that are now being handled by other employees.

We reduced costs at CXR Larus by reducing its work force and increasing our sourcing of test equipment components from Asian manufacturers that produce components for lower prices than we previously paid to our former suppliers. We terminated four employees during 2002, which resulted in annual savings of approximately $485,000, and an additional four employees in February 2003, which resulted in annual savings of approximately $306,000. Outsourcing of manufacturing to Asia was a primary reason we were able to increase our gross margin from 34% in 2002 to 67% in 2004 in our CXR Larus test equipment business, which resulted in an annual cost reductions of approximately $1,372,470 during 2004. We also reduced costs elsewhere in our communications equipment segment and lowered the breakeven point both in our United States and France operations through various cost-cutting methods, such as using Asian contract manufacturers, reducing facility rent expense by approximately $327,350 on an annual basis, and downsizing our administrative office in Paris, France. These cost-cutting efforts were a major factor in restoring our communications equipment segment to profitability in 2003 and 2004. However, we cannot predict if the recent improvement in telecommunications sales we are currently experiencing indicates the end of the severe telecommunications market downturn or the extent to which the downturn may continue to negatively affect our ability to sell our products and services to customers in the telecommunications industry.

In July 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. The basic purchase terms of the acquisition are described below. We consolidated the results of operations of Larus Corporation beginning from the date of acquisition, July 13, 2004. We expect increased sales of our French subsidiary's products in the United States market as a result of sales and marketing support for the French products by CXR Larus' United States-based sales and marketing staff. We have consolidated our CXR Larus subsidiary's operations into Larus Corporation's facility, which has resulted in administrative and facilities cost savings of approximately $20,000 during the period from October 1, 2004 to December 31, 2004 and is expected to result in additional cost savings of approximately $250,000 during 2005.

We paid $6,539,500 to acquire the outstanding common stock of Larus Corporation. As a result, we acquired 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 and approximately $580,000 of acquisition costs. The number of shares of our common stock issued as part of the purchase price was calculated based on the $0.824 per share average closing price of our common stock for the five trading days preceding the transaction. The warrants to purchase 150,000 shares of common stock were valued at $72,526 using a Black-Scholes formula that included a volatility of 107.19%, an interest rate of 3.25%, a life of three years and no assumed dividend.

In addition, we assumed $245,000 in accounts payable and accrued expenses and entered into an above-market real property lease with the sellers. This lease represents an obligation that exceeds 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 credit facility with Wells Fargo Bank, N.A. and cash on-hand.

In determining the purchase price for Larus Corporation, we 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 determining this premium, we considered our potential ability to refine various Larus Corporation products and to use our marketing resources and status as a qualified supplier to qualify and market those products for sale to large telecommunications companies. We believe that large telecommunications companies desired to have an additional choice of suppliers for those products and would be willing to purchase Larus Corporation's products following some refinements. We also believe that if Larus Corporation had remained independent, it was unlikely that it would have been able to qualify to sell its products to the large telecommunications companies due to its small size and lack of history selling to such companies. Therefore, Larus Corporation had a range of value separate from the net worth it had recorded on its books.

On March 18, 2005, XCEL Corporation Ltd. purchased all of the outstanding capital stock of Pascall Electronic (Holdings) Limited ("PEHL"), the parent company of Pascall, using funds loaned to XCEL Corporation Ltd. by Emrise. The initial purchase price was 3,100,000 British pounds sterling (approximately U.S. $5,972,000 based on the exchange rate in effect on March 18, 2005). The purchase price was paid in cash and is subject to upward or downward adjustment on a pound for pound basis to the extent that the value of the net assets of Pascall as of the closing date is greater or less than 2,520,000 British pounds sterling. The calculation of the value of the net assets of Pascall is to occur within six weeks after the closing, and Intelek Properties Limited (which is a subsidiary of Intelek PLC, a London Stock Exchange public limited company, and is the former parent of PEHL), will have 25 business days after receipt of the calculation to accept or dispute the calculation. Any payment relating to the increase or reduction of the purchase price based on the value of the net assets of Pascall will be due from XCEL Corporation Ltd. or Intelek Properties Limited, as the case may be, within 14 days of the acceptance

of the calculation. A default rate of interest equal to 3% above the base lending rate of Barclays Bank plc London will apply if the adjustment payment is not timely made. The purchase price is also subject to downward adjustments for any payments that may be made to XCEL Corporation Ltd. under indemnity, tax or warranty provisions of the purchase agreement.

XCEL Corporation Ltd. loaned to Pascall and PEHL at the closing 1,600,000 British pounds sterling (approximately U.S. $3,082,000 based on the exchange rate in effect on March 18, 2005) in accordance with the terms of a loan agreement entered into by those entities at the closing. The loaned funds were used to immediately repay outstanding intercompany debt owed by Pascall and PEHL to Intelek Properties Limited.

We and Intelek PLC have agreed to guarantee payment when due of all amounts payable by XCEL and Intelek Properties Limited, respectively, under the PEHL purchase agreement. Emrise and XCEL have agreed to seek to replace the guaranty that Intelek Properties Limited has given to Pascall's landlord with a guaranty from us, and XCEL 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 for a 30,000 square-foot administration, engineering and manufacturing facility located in Ryde, Isle of Wight, 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, non-interference with Pascall's customers and suppliers, and non-solicitation of Pascall's employees. In conjunction with the closing, Intelek Properties Limited, XCEL, Intelek PLC 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 U.S. $385,400 based on the exchange rate in effect on March 17, 2005) that was made by Intelek Properties Limited to Pascall on March 17, 2005 would be repaid by Pascall by March 31, 2005. XCEL agreed to ensure that Pascall has sufficient funds to repay the bridge loan. A default rate of interest equal to 3% above the base lending rate of Barclays Bank plc London will apply if the loan is not timely repaid.

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 these 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 components 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 delivery 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 components 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 components, 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. Product returns during 2004 were less than $1,000. 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 5.7%, 3.1% and 2.5% of net sales in 2004, 2003 and 2002, respectively.

INVENTORY VALUATION

Our finished goods electronic components 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. Demand for our products can fluctuate significantly. A significant increase in the demand for our products could result in a short-term increase in the cost of inventory purchases, while a significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand.

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. In the future, if our inventory is determined to be overvalued, we would be required to recognize such costs in our cost of goods sold at the time of such determination. Likewise, if

our inventory is determined to be undervalued, we may have over-reported our costs of goods sold in previous periods and would be required to recognize additional operating income at the time of sale. Therefore, 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 57.3% of our net revenues, 46.0% of our assets and 39.0% of our total liabilities as of and for the year ended December 31, 2004. 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 either included within our statement of operations or as a separate part of our net equity under the caption "accumulated other comprehensive income."

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 a cumulative translation gain of $487,000 that was included as part of accumulated other comprehensive income within our balance sheet at December 31, 2004. During 2004, we included translation adjustments of a gain of approximately $379,000 under accumulated other comprehensive income and 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 loss for 2004. 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 pounds sterling and the Japanese yen. Any future translation gains or losses could be significantly higher or lower than those we recorded for 2004.

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, 2004, the reported goodwill totaled $5,881,000 (net of accumulated amortization of $1,084,000). During 2004, 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 have commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. Although the valuation analysis is still in progress, we have estimated that the Larus tradename and trademark are valued at $2,800,000 and that the technology and customer relationships are valued at $800,000. Goodwill associated with the Larus Corporation acquisition totaled $3,363,000. The Larus tradename 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 and, as a result, $40,000 of amortization expense was recorded and charged to administrative expense in 2004. The valuation of the identified intangible assets is expected to be completed in May 2005 and could result in changes to the value of these identified intangible assets and corresponding changes to the value of goodwill. However, we do not believe these changes will be material to our financial position or results of operations.

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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, 2004 COMPARED TO YEAR ENDED DECEMBER 31, 2003

YEAR ENDED DECEMBER 31,		DOLLAR VARIANCE	PERCENT VARIAN
		FAVORABLE	FAVORAB
2004	2003	(UNFAVORABLE)	(UNFAVOR

(IN THOUSANDS)

Net sales				
Electronic components	$ 15,262	$ 16,168	$ (906)	(5.6
Communications equipment	$ 14,599	$ 9,351	$ 5,248	56.1
Total net sales	$ 29,861	$ 25,519	$ 4,342	17.0
Cost of sales				
Electronic components	$ 9,024	$ 9,530	$ (506)	(5.3
Communications equipment	$ 7,122	$ 5,305	$ 1,817	34.3
Total cost of sales	$ 16,146	$ 14,835	$ 1,311	8.8
Gross profit				
Electronic components	$ 6,238	$ 6,638	$ (400)	(6.0
Communications equipment	$ 7,477	$ 4,046	$ 3,431	84.8
Total gross profit	$ 13,715	$ 10,684	$ 3,031	28.4
Selling, general and administrative expenses ...	$ 10,226	$ 7,812	$ (2,414)	(30.9
Engineering and product development expenses ...	$ 1,521	$ 951	$ (570)	(59.9
Operating income	$ 1,968	$ 1,921	$ 47	2.4
Interest expense	$ 433	$ 416	$ (17)	(4.1
Other expense	$ (6)	$ (58)	$ 52	89.7
Income before income tax expense	$ 1,529	$ 1,447	$ 82	5.5
Income tax expense	$ 49	$ 286	$ 237	82.9
Net income	$ 1,480	$ 1,161	$ 319	27.5

NET SALES. The $4,342,000 (17.0%) increase in total net sales for 2004 as compared to 2003 resulted from the combination of a $906,000 (5.6%) decrease in net sales of our electronic components and a $5,248,000 (56.1%) increase in net sales of our communications equipment products and services.

ELECTRONIC COMPONENTS. The decrease in net sales of our electronic components segment resulted from:

- a $2,012,000 (20.1%) decrease in net sales of power supplies and subassemblies by XPS that we believe was primarily due to deferral of orders; and

- a $67,000 (23.1%) decrease in sales of electronic subsystem assemblies produced by Digitran that we believe was primarily due to a delay in the United States government's transfer of a contract from one prime contractor to another.

These decreases were only partially offset by the following:

- a $217,000 (4.1%) increase in net sales of switches manufactured by Digitran, which was primarily a result of an increase in the volume of orders for spare parts that we believe was mainly due to increased military activities;

- an increase from $1,000 in 2003 to $28,000 in 2004 in net sales of a new standard rotary switch and patent pending VLP(TM) rotary switches that were introduced by Digitran in 2004 and that we expect will continue to be additive to switch sales; and

- a $956,000 (164.3%) increase in net revenue from service and miscellaneous other electronic component products primarily due to increased service business volume at XPS.

COMMUNICATIONS EQUIPMENT. The increase in net sales of our communications equipment products and services resulted from:

- a $2,112,000 (34.4%) increase in net sales of network access and transmission equipment, which primarily consisted of $1,952,000 in sales made by CXR Larus as a direct result of our acquisition of Larus Corporation in July 2004;

- $1,298,000 of net sales of communication timing and synchronization products by CXR Larus from July through December 2004, prior to which time we did not have a similar product line; and

- a $1,677,000 (71.3%) increase in net sales of our CXR HALCYON 704 series field test equipment, which was primarily due to a $1,800,000 order we received and delivered in the fourth quarter of 2004 for a project that had been under development since 2002 and was only recently funded by the customer.

These increases were partially offset by the curtailment during 2004 of orders for CXR Larus test equipment by another large customer who shifted its focus to fiber and HDSL services. We do not expect 2005 sales of test equipment to equal our exceptionally good 2004 sales level.

GROSS PROFIT. The four percentage point increase in gross profit as a percentage of total net sales and the $3,031,000 (28.4%) increase in total gross profit in 2004 as compared to 2003 resulted from gross profit decreases in our electronic components segment that were more than offset by gross profit increases in our communications equipment segment.

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ELECTRONIC COMPONENTS. The $400,000 (6.0%) decrease in gross profit for our electronic components segment was primarily due to the large reduction in sales of power supplies described above.

COMMUNICATIONS EQUIPMENT. The $3,431,000 (84.8%) increase in gross profit for our communications equipment segment and the 7.9 percentage point increase in this segment's gross profit as a percentage of total net sales were primarily the result of the addition of Larus Corporation's $1,782,000 gross profit resulting from net sales of communication timing and synchronization products for July through December 2004 and a $1,587,000 increase in gross profit at CXR Larus as a result of a large increase in high gross margin sales of CXR Halcyon communications test equipment. Excluding the addition of Larus Corporation sales, gross profit for network access equipment increased approximately $60,000 (2.1%).

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. The $2,414,000 (30.9%) increase in selling, general and administrative expenses in 2004 as compared to

2003 resulted primarily from:

- $994,000 in selling, general and administrative expenses generated by Larus Corporation following its acquisition in July 2004;
- a $73,000 (12.0%) increase in sales expense at CXR Larus mostly related to the large orders they obtained during 2004;
- a $110,000 (53.9%) increase in selling expense at Digitran related to our new line of rotary switches;
- a $56,000 (19.6%) increase in selling expense at XPS to improve marketing of power supplies;
- a $99,000 (110.0%) increase in corporate legal fees and $67,000 (35.9%) increase in auditing fees partially due to Sarbanes-Oxley requirements;
- a $126,000 (91.3%) increase in deferred compensation;
- a $68,000 (42.5%) increase in stockholder relations and investor relations expenses;
- a $180,000 (18.3%) increase in corporate salaries, bonus and expenses partially due to foreign currency exchange rate fluctuation.

Some of the reasons for higher administrative expenses were increased acquisition activities, changing our name to Emrise Corporation, complying with the requirements of the Sarbanes-Oxley Act of 2002 and related rules, and increased investor relations activities.

ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES. Engineering and product development expenses consist primarily of research and product development activities. The $570,000 (59.9%) increase in these expenses resulted from:

- the inclusion of $200,000 of these expenses from Larus Corporation;
- an $80,000 (65.6%) increase in these expenses at CXR Larus relating to test instruments;
- a $53,000 (91.1%) increase in these expenses at CXR-AJ for network access equipment; and
- a $237,000 (96.7%) increase in expenses at Digitran for the new line of rotary switches.

INTEREST EXPENSE. Although our bank interest expense declined $58,000 (13.9%) due to our new credit line with Wells Fargo Bank, N.A., this benefit was more than offset by the $75,000 interest we paid on the notes we issued to acquire Larus Corporation.

INCOME TAX EXPENSE. Income tax expense for 2004 was $49,000 as compared to $286,000 in 2003. The 2004 tax provision was composed of $177,000 net foreign income taxes and $76,000 current federal and state taxes. These amounts were offset with a $160,000 reduction of the valuation allowance applied against the

deferred tax asset. The release of the allowance was based on the Company's recent and expected U.S. based earnings and the probability that a portion of its tax net operating loss carryforwards may be utilized.

NET INCOME. Net income increased by $319,000 (27.5%) to $1,480,000 in 2004 from $1,161,000 in 2003. Our 2004 net income was helped by the contribution of $628,000 of operating earnings from Larus Corporation, a $1,414,000 increase in operating earnings by CXR Larus due to improved test instrument sales and an improvement of $319,000 in operating earnings at CXR-AJ due to increased network access sales. These improvements were partially offset by lower operating earnings at our electronics components segment due to higher operating expenses at Digitran and lower gross margin at XPS due to a lower sales volume of power supplies. These changes resulted in our net income before taxes in 2004 of $1,529,000, $82,000 over 2003 net income before tax of $1,447,000. Our income tax provision in 2004 was $49,000 as compared to $286,000 in 2003.

YEAR ENDED DECEMBER 31, 2003 COMPARED TO YEAR ENDED DECEMBER 31, 2002

	YEAR ENDED DECEMBER 31,		DOLLAR VARIANCE	PERCENT VARIAN
	2003	2002	FAVORABLE (UNFAVORABLE)	FAVORAB (UNFAVOR
			(IN THOUSANDS)	
Net sales				
Electronic components	$ 16,168	$ 13,390	$ 2,778	
Communications equipment	$ 9,351	$ 9,274	$ 77	
Total net sales	$ 25,519	$ 22,664	$ 2,855	
Cost of sales				
Electronic components	$ 9,530	$ 8,187	$ (1,343)	(
Communications equipment	$ 5,305	$ 5,960	$ 655	
Total cost of sales	$ 14,835	$ 14,147	$ (688)	
Gross profit				
Electronic components	$ 6,638	$ 5,203	$ 1,435	
Communications equipment	$ 4,046	$ 3,314	$ 732	
Total gross profit	$ 10,684	$ 8,517	$ 2,167	
Selling, general and administrative expenses ...	$ 7,812	$ 7,731	$ (81)	
Engineering and product development expenses ...	$ 951	$ 1,015	$ 64	
Operating income (loss)	$ 1,921	$ (229)	$ 2,150	9
Interest expense	$ (416)	$ (441)	$ 25	
Other (expense) income.........................	$ (58)	$ 80	$ (138)	(1
Income before income tax expense	$ 1,447	$ (590)	$ 2,037	3
Income tax expense (benefit)	$ 286	$ (20)	$ (306)	(1,5
Net income (loss)	$ 1,161	$ (570)	$ 1,731	3

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NET SALES. The $2,855,000 (12.6%) increase in total net sales for 2003 resulted primarily from the significant growth in overall net sales of our electronic components and the slight increase in overall net sales of our communications equipment products and services.

The $2,778,000 (20.7%) increase in net sales of our electronic components included a $2,841,000 (39.7%) increase in net sales of power supplies and related electronic subsystem assemblies due to an increase in the number of products XPS shipped under long-term programs, and a $563,000 (11.9%) increase in sales of digital switches manufactured by Digitran that primarily resulted from an increase in orders for spare parts that we believe was mainly due to increased military activities. These increases were partially offset by a $835,000 (74.2%) reduction in subsystem assembly sales by Digitran due to the completion of a major contract in 2002.

The $77,000 (0.8%) increase in net sales of our communications equipment products and services included a $740,000 (13.7%) increase in sales of network access and transmission products, which was partially offset by a $528,000 (18.3%) decline in sales of test equipment by CXR Larus and CXR-AJ. We decided to terminate the resale of test equipment by CXR-AJ in November 2000 and now have only residual sales of these products in Europe. Test equipment sales decreased primarily due to a reduction in orders from telecommunications customers in the United States, which we believe was primarily due to the weak telecom market and the continuing effect of CXR-AJ's discontinuation of test equipment resales.

CXR-AJ produced all of our transmission products and network access equipment before we acquired Larus Corporation in July 2004. Net sales by CXR-AJ of such products, excluding test equipment, increased by $740,000 (13.7%) due to increased sales volume.

Net sales of our CXR HALCYON 704 series field test equipment increased slightly by $37,000 (1.9%). We aggressively marketed to non-telecommunications customers, such as government agencies, electric utilities and transportation agencies, which resulted in improved sales of our CXR HALCYON products to non-telecommunications customers. Nevertheless, CXR Telecom's major customers are the large United States telecommunications companies, and their capital budget expenditures for CXR HALCYON equipment were still low in terms of our historical experience.

We believe that many of the United States telecom customers that CXR Larus serves built networks to handle an anticipated demand for voice and data traffic that has not yet occurred. Consequently, many of these customers reduced their purchasing budgets for 2002 and 2003, which had a negative impact on CXR Larus' sales.

GROSS PROFIT. Improvements in gross profit of both of our operating segments contributed to the $2,167,000 (25.4%) total gross profit increase and to the 4.3 percentage point increase in total gross profit to 41.9% of total net sales.

The gross profit increase for our electronic components segment primarily resulted from increases in the profit margins of both digital switches and power supplies due to changes in product mix for both switch and XPS's power

supply products. Also, increased volume helped increase gross margins of power supplies by reducing per unit costs.

The increase in gross profit as a percentage of net sales for our communications equipment segment primarily was due to reduced costs. CXR Larus and CXR-AJ increased their gross margins as a percent of sales to 45.0% and 42.6% from 34.1% and 36.7%, respectively, due to cost reductions and higher sales at CXR-AJ.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. The 3.5 percentage point decrease in selling, general and administrative expenses to 30.6% of total net sales resulted from maintaining relatively level expenses in combination with increased sales. Selling expenses remained static in 2003 as compared to 2002. General and administrative expenses increased modestly by $77,000 (1.5%).

ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES. Engineering and product development expenses consist primarily of research and product development activities of our communications equipment segment and Digitran. The $64,000 (6.3%) decrease primarily resulted from cost reductions in the communications equipment segment.

INTEREST EXPENSE. Interest expense decreased by $25,000 (5.7%) generally due to lower average debt balances at XPS and CXR-AJ.

OTHER (EXPENSE) INCOME. Other expense was $58,000 for 2003 as compared to other income of $80,000 for 2002, primarily due to foreign currency losses.

INCOME TAX EXPENSE (BENEFIT). The majority of the increase in income tax expense related to the recording by XPS of a provision for United Kingdom income tax that was required because XPS produced greater taxable income for 2003 than in 2002 and has consumed its net operating loss carryforwards.

NET INCOME (LOSS). The $1,731,000 improvement in net income (loss) resulted from a number of factors. The largest contributors to this positive change were $1,099,000 and $856,000 increases in operating income of XPS and CXR-AJ, respectively, due to increased sales at XPS and increased sales and reduced costs at CXR-AJ. In addition, CXR Larus improved its operating income by $486,000 by reducing costs. We continued to closely monitor costs throughout our operations and reduced costs through staffing reductions in our communications equipment operations in the United States and France and through various other cost-cutting methods, such as using contract manufacturers and reducing facility rent expense. These actions substantially reduced the sales volume required to produce profitability at both CXR Larus and CXR-AJ.

LIQUIDITY AND CAPITAL RESOURCES

During the year ended December 31, 2004, we funded our operations primarily through revenue generated from our operations and through our existing and previous lines of credit with Wells Fargo Bank, N.A., Wells Fargo Business Credit, Inc. and various foreign banks. As of December 31, 2004, we had working capital of $4,839,000, which represented a decrease of $901,000 (15.8%) from working capital of $5,696,000 at December 31, 2003, primarily due to the acquisition of Larus Corporation. Also, at December 31, 2004, we had an accumulated deficit of $16,406,000, accumulated other comprehensive income of $487,000, and cash and cash equivalents of $1,057,000. As of December 31, 2003, we had an accumulated deficit of $17,886,000, accumulated other comprehensive income of $108,000, and cash and cash equivalents of $1,174,000.

Accounts receivable increased $403,000 (7.5%) to $5,796,000 as of December 31, 2004 from $5,393,000 as of December 31, 2003. Sales attributable to the Larus Corporation acquisition contributed $1,308,000 to the increase. Without the acquisition of Larus Corporation, our receivables would have decreased $1,025,000 to $4,368,000 at December 31, 2004, primarily due to a $1,800,000 order for test instruments that we shipped, invoiced and collected in the fourth quarter of 2004. Days sales outstanding, which is a measure of our average accounts receivable collection period, improved during the 2004 from 72 to 69 days. Our customers include many Fortune 500 companies in the United States and similarly large companies in Europe and Asia. Because of the financial strength of our customer base, we have virtually eliminated our bad debt reserves.

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Inventory balances decreased 2.9% during 2004, from $6,683,000 at December 31, 2003 to $6,491,000 at December 31, 2004. Inventory represented 27.4% and 39.0% of our total assets as of December 31, 2004 and 2003, respectively. Included in the December 31, 2004 inventory amount is the $1,411,000 of inventory of Larus Corporation. We acquired Larus Corporation in July 2004. Excluding the effect of this inclusion, inventory would have decreased by $1,683,000 (24.0%) and would have represented 33.4% of total assets (excluding the $8,454,000 of total assets related to Larus Corporation) at December 31, 2004. Inventory turnover, which is a ratio that indicates how many times our inventory is sold and replaced over a specified period, improved to 2.6 times for 2004 as compared to 2.4 times for 2003.

We took various actions to reduce costs in 2004. These actions were intended to reduce the cash outlays of our telecommunications equipment segment to match its revenue rate. We also have contracted with Asian manufacturers for production of test equipment components at lower prices than we previously paid to our former suppliers and have received shipments of quality components from these Asian suppliers.

Cash provided by our operating activities totaled $3,884,000 for 2004, an improvement of $2,737,000 as compared to cash provided by our operating activities of $1,039,000 for 2003. This increase in cash provided by operations during 2004 primarily resulted from improved net income, a reduction of our inventory (excluding Larus Corporation inventory) due to outsourcing and inventory management, and an increase in our trade payables balance.

Cash used in our investing activities totaled $2,208,000 for 2004 as compared to $38,000 used in our investing activities for 2003. Included in the results for 2004 are net cash of $1,492,000 to acquire Larus Corporation and $724,000 of property, plant and equipment purchases for production facility upgrade, telecommunications, management information systems and computer controlled production machinery for our new low profile rotary and digital switches. The investments for 2003 were mostly property, plant and equipment purchases.

Cash used in our financing activities totaled $2,164,000 for 2004 as compared to $687,000 of cash used in our financing activities for 2003, due to larger repayments of bank debt in 2004 than in 2003.

On June 1, 2004, XET Corporation and CXR Larus, together with Emrise acting as guarantor, obtained a credit facility from Wells Fargo Bank, N.A. for our domestic operations. This facility is effective through July 1, 2005 and replaced the previous credit facility we had with Wells Fargo Business Credit,

Inc. No prepayment penalty was due because the prior loan contract excluded from prepayment penalties loans replaced with new credit facilities from Wells Fargo Bank, N.A. Also, the new credit facility has no minimum interest but is subject to an unused commitment fee equal to 0.25% per annum, payable quarterly based on the average daily unused amount of the line of credit described in the following paragraph.

The new credit facility provides a $3,000,000 revolving line of credit secured by accounts receivable, other rights to payment and general intangibles, inventories and equipment. Borrowings do not need to be supported by specific receivables or inventory balances unless aggregate borrowings under the line of credit and the term loan described in the following paragraph exceed $2,000,000 for 30 consecutive days (a "conversion event"). If a conversion event occurs, the line of credit will convert into a formula-based line of credit until the borrowings are equal to or less than $2,000,000 for 30 consecutive days. The formula generally provides that outstanding borrowings under the line of credit

may not exceed an aggregate of 80% of eligible accounts receivable, plus 15% of the value of eligible raw material inventory, plus 30% of the value of eligible finished goods inventory. The interest rate is variable and is adjusted monthly based on the prime rate plus 0.5%. The prime rate at December 31, 2004 was 5.0%.

The previous credit facility bore interest at the prime rate plus 1.0% and was subject to a $13,500 minimum monthly interest fee plus an unused commitment fee equal to 0.25% per annum. The average amount outstanding on the revolving portions of the previous and new credit facilities during 2004 was $1,035,000. The prime rate averaged approximately 4.25% in 2004. Therefore, the average annual interest cost on the new revolving line of credit was approximately $49,162 while the average annual interest cost on the prior revolving line of credit was approximately $162,000 due to the minimum interest rate charge of $13,500 per month.

The new credit facility also provides 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%. The term loan portion of the facility had a balance of $126,000 at December 31, 2004.

Wells Fargo Bank, N.A. has also provided us with $300,000 of credit available for the purchase of new capital equipment when needed, of which a balance of $58,000 was outstanding at December 31, 2004.

At December 31, 2004, we had a balance owing under the revolving credit line of $118,000, and we had $1,882,000 of availability on the non-formula based portion of the credit line. The credit facility is subject to various financial covenants. The minimum debt service coverage ratio of each of XET Corporation and CXR Larus must be not less than 1.50:1.00 on a trailing four-quarter basis. "Debt service coverage ratio" is defined as net income plus depreciation plus amortization, minus non-financed capital expenditures, divided by current portion of long-term debt measured quarterly. The current ratio of each of XET Corporation and CXR Larus must be not less than 1.50:1.00, determined as of each fiscal quarter end. "Current ratio" is defined as total current assets divided by total current liabilities. Net income after taxes of each of XET Corporation and CXR Larus must be not less than $1.00 on an annual basis, determined as of the end of each quarter. Net profit after taxes of each of XET Corporation and CXR Larus must be not less than $1.00 in each fiscal quarter immediately following a fiscal quarter in which that entity incurred a net loss after taxes.

Total liabilities divided by tangible net worth of our domestic operations on a consolidated basis must not at any time be greater than 2.00:1.00, determined as of each fiscal quarter end. Tangible net worth of us and all of our subsidiaries on a consolidated basis must not at any time be less than $5,200,000, measured at the end of each quarter. "Total liabilities" is defined as current liabilities plus non-current liabilities, minus subordinated debt. "Tangible net worth" is defined as stockholders' equity plus subordinated debt, minus intangible assets.

At December 31, 2004, we were in compliance with the covenants other than the debt-to-tangible net worth covenant for our domestic operations. We obtained a waiver of non-compliance as of December 31, 2004. We are currently engaged in discussions with Wells Fargo Bank, N.A. to amend the existing financial covenants effective as of the next measurement date of April 30, 2005. If we are unable to comply with the existing or revised covenants and are unable to obtain a waver or amendment on reasonable terms, the amount outstanding on the line of credit would become due and payable and a default interest rate of prime plus 4.5% would apply. The facility expires in July 2005. At March 31, 2005, there was no balance outstanding under the revolving line of credit. We currently intend to seek renewal of the facility and believe that the bank will be amenable to renewing it. However, if we are unable to obtain a renewal of the facility, we believe we will have sufficient funds available to timely repay any additional amounts we may borrow under the facility prior to its expiration.

On July 13, 2004, we 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 we repaid in 2004, in exchange for 100% of the capital stock of Larus Corporation. These notes are subordinated to our bank debt and are payable in 72 equal monthly payments of principal totaling $41,667 per month plus interest at the 30-day London InterBank Offered Rate ("LIBOR") rate 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. During December 2004, the LIBOR rate was 2.42%. The total balance on these promissory notes as of December 31, 2004 was $2,750,000.

As of December 31, 2004, our foreign subsidiaries had credit facilities, including lines of credit and term loans, with Venture Finance PLC, a subsidiary of the global Dutch ABN AMRO Holdings, N.V. financial institution, 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. As of December 31, 2004, the balances outstanding under our United Kingdom, France and Japan credit facilities were $903,000, $634,000 and $56,000, respectively.

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 balance of the loan as of December 31, 2004 was $56,000 using the exchange rate in effect at that date for conversion of Japanese yen into United States dollars. There are no financial performance covenants applicable to this loan.

XPS, one of our United Kingdom subsidiaries, obtained a credit facility with Venture Finance PLC in November 2002. This credit facility expires on November 15, 2005. Using the exchange rate in effect at December 31, 2004 for the conversion of British pounds sterling into United States dollars, the facility is for a maximum of $2,865,000 and includes a $669,000 unsecured cash

flow loan, a $153,000 term loan secured by fixed assets, and the remainder is a loan secured by accounts receivable and inventory. The interest rate is the base rate of Venture Finance PLC (4.75% at December 31, 2004) plus 2%, and is subject to a minimum rate of 4% per annum. There are no financial performance covenants applicable to this credit facility.

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 $1,488,000, based on the exchange rate in effect at December 31, 2004 for the conversion of euros into United States dollars. CXR-AJ also had $62,000 of term loans with several French banks outstanding as of December 31, 2004. The IFN Finance facility is secured by accounts receivable and carries an annual interest rate of 1.6% above the French "T4M" rate. The French T4M rate was 2.04% and had a balance of $572,000 at December 31, 2004. This facility has no financial performance covenants.

Our backlog was $7,720,000 as of December 31, 2004 as compared to $9,630,000 as of December 31, 2003. The reduction in backlog was primarily due to substantial shipments under contracts by XPS in the United Kingdom. Our backlog as of December 31, 2004 was 82.3% related to our electronic components business, which business tends to provide us with long lead-times for our manufacturing processes due to the custom nature of the products, and 17.7% 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.

As described above under the heading "Overview," we acquired Larus Corporation and Vista in July 2004. As a result of the acquisition, we acquired all of the assets and liabilities of Larus Corporation, including the intellectual property, cash, accounts receivable and inventories owned by each of Larus Corporation and Vista. The $6,539,500 purchase price 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, and approximately $580,000 of acquisition costs. In addition, we assumed $245,000 worth of accounts payable and accrued expenses and entered into an above-market seven-year real property lease with the sellers. This lease represents an obligation that exceeds the fair market value by approximately $756,000 and is part of the acquisition accounting. We funded the cash portion of the purchase price using proceeds from our credit facility with Wells Fargo Bank, N.A. and our cash on-hand.

On January 5, 2005, we 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 a total purchase price of $18,005,000. 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.

Additional costs related to the financing include legal, accounting and consulting fees that continue to be incurred in connection with the resale registration described below.

We agreed to register for resale the shares of common stock issued to investors and the shares of common stock issuable upon exercise of the investor warrants and placement warrants. The registration obligations require, among other things, that a registration statement be declared effective no later than the 150th day following the closing date. If we are unable to meet this obligation or unable to maintain the effectiveness of the registration in accordance with the requirements contained in the registration rights agreement we entered into with the investors, then we will be required to pay to each investor liquidated damages equal to 1% of the amount paid by the investor for the common shares still owned by the investor on the date of the default and 2% of the amount paid by the investor for the common shares still owned by the investor on each monthly anniversary of the date of the default that occurs prior to the cure of the default. The maximum aggregate liquidated damages payable to any investor will be equal to 10% of the aggregate amount paid by the investor for the shares of our common stock. Accordingly, the maximum aggregate penalty that we would be required to pay under this provision is 10% of the $18,005,000 initial purchase price of the common stock, which would be $1,801,000. Although we anticipate that we will be able to meet our registration obligations, we also anticipate that we will have sufficient cash available to pay these penalties if required.

We used a portion of the proceeds from the January 2005 financing to fund the acquisition of Pascall described above under the heading "Overview." In connection with the Pascall acquisition, we loaned to XCEL Corporation Ltd. approximately $10,100,000 in cash that was used to acquire Pascall and to repay Pascall's existing intercompany debt. As described above, the Pascall purchase price is subject to upward or downward adjustment and we have guaranteed obligations of XCEL Corporation Ltd. in connection with the Pascall acquisition and have agreed to indemnify Pascall's former parent in connection with obligations under Pascall's facilities lease.

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 rate.

PAYMENTS DUE BY PERIOD

(IN THOUSANDS)

CONTRACTUAL OBLIGATIONS AT DECEMBER 31, 2004	2005	2006	2007	2008	2009	THERE-AFTER
Line of Credit (Domestic)	$ 118	$ --	--	$ --	$ --	$ --
Average Interest Rate	P+0.5%					
Line of Credit (U.K.)	$ 188	$ --	--	--	--	--

Average Interest Rate	B+2%					
Overdraft (France)	$ 572	$ --	--	--	--	--
Average Interest Rate	3.74%					
Term Loan From Stockholders (Domestic)	$ 500	$ 500	500	$ 500	$ 500	$ 250
Average Interest Rate	P+1.5%, L+5.0%					
Capital Equipment Loan (U.S.)	$ 13	$ 13	13	$ 13	$ 6	$ --
Average Interest Rate	L+4%					
Term Loans (U.S.)	$ 44	$ 44	38	$ --	$ --	$ --
Average Interest Rate	P+1.5%					
Term Loan (U.K.)	$ 46	$ 669	--	$ --	$ --	$ --
Average Interest Rate	B+2%					
Term Loans (France)	$ 23	$ 23	16	$ --	$ --	$ --
Average Interest Rate	1.2%-5.6%					
Term Loan (Japan)	$ 19	$ 19	18	$ --	$ --	$ --
Average Interest Rate	3.25%					
Capitalized Lease Obligations	$ 66	$ 60	12	$ 12	$ 12	$ 17
Operating Leases	$ 1,040	$ 713	725	$ 527	$ 420	$ 486
	$ 2,629	$ 2,041	1,322	$ 1,032	$ 938	$ 753

We intend to grow our business through both internal growth and through 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 our stock.

We believe that current and future available capital resources, revenues generated from operations, and other existing sources of liquidity, including the credit facilities we have and the remaining proceeds we have from the January 2005 financing, will be adequate to meet our anticipated working capital and capital expenditure requirements for at least the next twelve

months. If, however, our capital requirements or cash flow vary materially from our current projections, if 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 effect 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

In December 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits," an amendment of SFAS No. 87, 88 and 106, and a revision of SFAS No. 132. The statement is effective for fiscal years and interim periods ending after December 15, 2003. This statement revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by SFAS No. 87, 88 and 106. The new rules require additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans. The adoption of this statement did not have a material effect on our financial condition or results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," which addresses the accounting for employee stock options. SFAS No. 123R eliminates the ability to account for shared-based compensation transactions using APB Opinion No. 25 and generally would require instead that such transactions be accounted for using a fair value-based method. SFAS No. 123R also requires that tax benefits associated with these share-based payments be classified as financing activities in the statement of cash flow rather than operating activities as currently permitted. SFAS No. 123R becomes effective for interim or annual periods beginning after June 15, 2005. Accordingly, we are required to apply SFAS No. 123R beginning in the quarter ending September 30, 2005. SFAS No. 123R offers alternative methods of adopting this final rule. At the present time, we have not yet determined which alternative method we will use.

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 are effective for our fiscal 2006. We are currently evaluating the provisions of SFAS No. 151 and do not expect that adoption will have a material effect on our financial position, results of operations or cash flows.

SELECTED QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following table sets forth selected quarterly financial data for each full quarter within the two most recent fiscal years. This quarterly information is unaudited, has been prepared on the same basis as our annual financial statements, and, in our opinion, reflects all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the information for periods presented. Operating results for any quarter are not necessarily indicative of results for any future period.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME DATA:	QUARTER ENDED, DEC. 31, 2004	SEPT. 30, 2004	JUNE 30, 2004	MAR. 31, 2004	DEC. 31, 2003
Net sales	$ 9,768	$ 7,469	$ 6,432	$ 6,192	$ 6,597
Cost of sales	4,929	4,239	3,533	3,445	3,598
Gross profit	4,839	3,230	2,899	2,747	2,999
Selling, general and administrative expenses	3,477	2,465	2,067	2,217	2,280
Engineering and product development expenses	488	438	312	283	254
Income (loss) from operations	874	327	520	247	465
Other income (expenses), net	(70)	(143)	(124)	(102)	(161)
Income (loss) before income taxes	804	184	396	145	304
Income tax expense	(79)	26	27	75	50
Net income (loss)	883	$ 158	$ 369	$ 70	$ 254
Other comprehensive gain (loss), net	437	6	(62)	(2)	344
Total comprehensive income (loss)	1,320	$ 164	$ 307	$ 68	$ 598
Basic earnings (loss) per share	$ 0.04	$ 0.01	$ 0.02	$ 0.00	$ 0.01
Diluted earnings (loss) per share	$ 0.03	$ 0.01	$ 0.02	$ 0.00	$ 0.01

The following table sets forth a portion of the above unaudited information as a percentage of net sales.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME DATA:	QUARTER ENDED, DEC. 31, 2004	SEPT. 30, 2004	JUNE 30, 2004	MAR. 31, 2004	DEC. 31, 2003
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales	50.5	56.8	54.9	55.6	54.5
Gross profit	49.5	43.2	45.1	44.4	45.5
Selling, general and administrative expenses	35.6	33.0	32.1	35.8	34.6
Engineering and product development expenses	5.0	5.9	4.9	4.6	3.9
Income (loss) from operations	8.9	4.3	8.1	4.0	7.0
Other income (expenses), net	(0.7)	(1.9)	(2.0)	(1.7)	(2.4)
Income (loss) before income taxes	8.2	2.4	6.1	2.3	4.6
Net income (loss)	9.0	2.1	5.7	1.1	3.9
Other comprehensive gain (loss), net	4.5	0.0	(1.0)	0.0	5.2
Total comprehensive income (loss)	13.5%	2.1%	4.7%	1.1%	9.1%

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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, changes in foreign currency conversion rates and new accounting pronouncements that may affect the consistency in the generally accepted accounting principles that we use. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Overview."

Our operating results have fluctuated from quarter to quarter due to a variety of reasons. We note below some of the larger changes in various line items in the table above.

QUARTER ENDED DECEMBER 31, 2004 COMPARED TO QUARTER ENDED SEPTEMBER 30, 2004

Net sales increased by $2,299,000 (31%) to $9,768,000 from $7,469,000 in the previous period. Communications test equipment sales increased by $1,706,000 primarily because shipments that were planned to occur during the third quarter were postponed until the fourth quarter due to slower release of orders from an RBOC. Communication timing and synchronization product sales increased by $278,000 (55%) to $788,000 as compared to $510,000 for the previous quarter primarily because the prior period did not reflect a full quarter of revenues from Larus Corporation, which subsidiary we acquired in July 2004. Gross profit increased by $1,609,000 (50%) to $4,839,000 from $3,230,000 due to changes in sales volume and product mix attributable to the postponed shipments noted above, which related to higher margin items. Operating costs increased by $1,062,000 (36%) to $3,965,000 from $2,903,000 due to higher commissions on increased revenue, additional accruals for legal and audit fees, expenses related to Sarbanes-Oxley compliance, bonus accruals, reclassification of pension expense for CXR-AJ, addition of sales staff, and an increase in accrual for payments under a previous acquisition. Net income increased to $883,000 from $158,000 primarily because of the improved revenue and gross margin increase discussed above.

QUARTER ENDED SEPTEMBER 30, 2004 COMPARED TO QUARTER ENDED JUNE 30, 2004

Net sales increased by $1,037,000 (16%) to $7,469,000 from $6,432,000 in the previous period. In July 2004, we acquired Larus Corporation, which contributed $1,468,000 in sales in the third quarter. The additional sales provided by Larus Corporation were partially offset with a $197,000 decline in test instruments sales and a $126,000 reduction in sales of our European network access products. Our gross profit increased by $331,000 (11%) to $3,230,000 from $2,899,000 in the prior period. Larus Corporation contributed $595,000 of gross profit, which was partially offset with a reduction in gross profit of test instruments of $153,000 primarily due to lower sales and switches of $111,000 due mainly to product mix. Gross margin was 43% as compared to 45% for the previous quarter. Operating costs increased by $524,000 (22%) to $2,903,000 from $2,379,000 primarily because of the addition of $534,000 of Larus Corporation's operating expenses. Net income declined to $158,000 as compared to $369,000 for the second quarter primarily because operating expenses increased more than the increase in gross profit.

QUARTER ENDED JUNE 30, 2004 COMPARED TO QUARTER ENDED MARCH 31, 2004

Net sales increased by $240,000 (4%) to $6,432,000 from $6,192,000 in the prior quarter primarily due to increased test equipment sales of $735,000, which was $253,000 above the prior period. Net sales in other product lines remained relatively consistent. Gross profit increased by $152,000 (6%) to $2,899,000 from $2,747,000 in the prior period mainly due to increased test equipment sales. The gross margin increased to 45% from 44% in the previous quarter. Operating costs decreased $121,000 (5%) to $2,379,000 from $2,500,000 in the prior quarter primarily mainly due to lower sales commission expense. Net income rose to $369,000 from $70,000 in the first quarter primarily due to higher sales, higher gross profit margin, lower income tax expense and lower operating costs.

QUARTER ENDED MARCH 31, 2004 COMPARED TO QUARTER ENDED DECEMBER 31, 2003

Net sales decreased by $405,000 (6%) to $6,192,000 from $6,597,000 in the prior quarter. The primary reason for the decrease was a $300,000 decrease in test instrument sales mostly due to the budget cycles of our large test instrument customers. Also, lower power supply product shipments were partially offset with increased switch sales. Gross profit decreased by $252,000 (8%) to $2,747,000 from $2,999,000 in the previous quarter primarily due to lower sales. The gross margin declined to 44% from 46% mainly due to the decrease in test equipment sales. Operating expenses stayed consistent. Net income declined to $70,000 from $254,000 mainly because of the lower test instrument sales.

QUARTER ENDED DECEMBER 31, 2003 COMPARED TO QUARTER ENDED SEPTEMBER 30, 2003

Net sales increased by $177,000 (3%) to $6,597,000 from $6,420,000 in the prior period. Communication equipment sales increased by $662,000 due to a large increase in the sales of network access products in Europe and a modest increase in test equipment sales. This increase was partially offset with a $485,000 decrease in sales of electronic components of both power supplies and switches. Despite a small decrease in total sales, gross profit increased $284,000 (10%) to $2,999,000 from $2,715,000 in the prior quarter due mainly to a higher gross margin on power supplies. Gross margin increased to 46% as compared to 42% in the prior quarter. Operating expenses increased $388,000 (18%) to $2,534,000 from $2,146,000 due to increases in sales and administrative expenses. Net income was $254,000 as compared to $504,000 in the third quarter.

QUARTER ENDED SEPTEMBER 30, 2003 COMPARED TO QUARTER ENDED JUNE 30, 2003

For the third quarter of 2003, net sales decreased $414,000 (6%) to $6,420,000 from $6,834,000 in the prior quarter. This decrease was primarily due to reduced network access equipment sales in Europe. Sales of electronic components increased slightly despite a 6% decrease in sales of power supplies. Gross profit was $2,715,000, which was $114,000 (4%) less than the prior quarter gross profit of $2,829,000. Despite lower sales, we increased our gross profit margin in both of our business segments by reducing costs. Our gross margin improved to 42% from 41% in the prior period. Operating costs were relatively unchanged with administrative costs declining slightly and sales and marketing increasing slightly. Net income was $504,000 as compared to $359,000 in the prior period. The difference in net income was primarily caused by income tax expense that was $116,000 less in the third quarter as compared to the second quarter related to changes in United Kingdom tax liability.

QUARTER ENDED JUNE 30, 2003 COMPARED TO QUARTER ENDED MARCH 31, 2003

Net sales increased by $1,166,000 (21%) to $6,834,000 from $5,668,000 in the prior quarter. Communications equipment sales increased $259,000 due to increased sales of test instruments, and electronic components sales increased $907,000 due to stronger switch and power supply sales. Gross profit increased by $688,000 (32%) to $2,829,000 from $2,141,000 in the prior quarter due to higher gross margins across our product lines. Gross margins improved to 41% from 38%. Operating expenses increased by $245,000 (13%) to $2,164,000 from $1,919,000 in the prior quarter primarily due to higher administrative costs because of increased staffing at our electronic components segment. The higher sales of the second quarter and improved margins resulted in net income of $359,000 in the second quarter as compared to net income of $44,000 in the first quarter.

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 of our international subsidiaries. However, because historically the majority of our currency exposure has related to financial statement translation rather than to particular transactions, we do not intend to enter into, nor have we historically 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 "Management's Discussion and Analysis of Financial Condition and Results of Operations - 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.

The following table provides information about our debt obligations that are sensitive to changes in interest rates. 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. Balances are as of December 31, 2004.

LIABILITIES	2005	2006	2007	2008	2009	THERE-AFTER

Line of Credit (Domestic)	$ 118	$ --	$ --	$ --	$ --	$ --	$
Average Interest Rate	P+ 0.5%						
Line of Credit (U.K.)	$ 188	$ --	$ --	$ --	$ --	$ --	$
Average Interest Rate	B+2.0%						
Overdraft (France)	$ 572	$ --	$ --	$ --	$ --	$ --	$
Average Interest Rate	3.74%						
Term Loan From Stockholders (Domestic)	$ 500	$ 500	$ 500	$ 500	$ 500	$ 250	$
Average Interest Rate	P+1.52%, L+5.0%						
Term Loan (U.K.)	$ 46	$ 669	$ --	$ --	$ --	$ --	$
Average Interest Rate	B+2.0%						
Term Loans (France)	$ 23	$ 23	$ 16	$ --	$ --	$ --	$
Average Interest Rate	5.2%-5.6%						
Term Loan (Japan)	$ 19	$ 19	$ 18	$ --	$ --	$ --	$
Average Interest Rate	3.25%						
Capital Equipment Loan (U.S.)	$ 13	$ 13	$ 13	$ 13	$ 13	$ 6	$
Average Interest Rate	L+4%						
Term Loans (U.S.)	$ 44	$ 44	$ 38	$ --	$ --	$ --	$
Average Interest Rate	P+1.5%						

BUSINESS

CORPORATE OVERVIEW

We are a Delaware corporation that was formed July 14, 1989. We have three wholly-owned operating subsidiaries, XET Corporation, a New Jersey corporation that was formed in 1983, 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"). XET Corporation and its subsidiaries design, develop, manufacture and market electronic components 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 manufactures and sells communication timing and synchronization products.

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 the prospectus, we acquired Larus Corporation and Vista Labs, Incorporated in July 2004.

In March 2005, XCEL Corporation Ltd., a United Kingdom-based subsidiary of XET Corporation, acquired Pascall Electronic (Holdings) Limited and its wholly-owned subsidiary, Pascall Electronics Limited ("Pascall"). Pascall is based in the United Kingdom and manufactures a range of proprietary power systems and radio frequency ("RF") components and subsystems.

Through our operating subsidiaries, CXR Larus, CXR-AJ and XET

Corporation, 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 Components
  - digital and rotary switches
  - electronic power supplies
  - RF components
  - subsystem assemblies
- 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 components segment, primarily to defense and aerospace customers, defense contractors and industrial customers, were 51.1%, 63.4% and 59.1% of our total net sales for the years 2004, 2003 and 2002, respectively. Sales of communications equipment and related services, primarily to private telecommunications network customers and public carriers, were 48.9%, 36.6% and 40.9% of our total net sales during the years 2004, 2003 and 2002, respectively.

Our objective in our electronic components business is to become the supplier of choice for harsh environment digital and rotary switches, custom power supplies and RF and microwave products. 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 COMPONENTS

The electronic components industry comprises three basic segments, which are active components, passive components and electromechanical components. 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 components.

We are active only in the industry segments that are characterized by 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, we believe that our electronic components 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 components, makes use of sophisticated electronic assemblies in diverse applications that involve both original equipment and retrofit of existing equipment.

The Digitran division of XET Corporation ("Digitran"), which division was acquired by XET Corporation from Becton Dickinson in 1985, has been manufacturing digital switches since the division was formed in the 1960s. XCEL Power Systems Ltd. ("XPS"), a second tier subsidiary of XET Corporation, 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 major growth and have become a critical part of the global business and economic infrastructure that has been driven by:

- 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. DSL, or digital subscriber line, technology transmits data up to 50 times faster than a conventional dial-up modem using existing copper telephone wires. We believe that the demand for test equipment with which to test, deploy, manage and optimize communications networks, equipment and services remains depressed for public carrier markets.

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 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 transmission devices and advanced field and central or branch office testing and monitoring solutions.

OUR SOLUTION

We have developed a range of electronic components, such as digital and rotary switches, custom electronic power supplies and RF components and subsystems, used primarily by aerospace, defense and industrial customers. 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 broad range of test instruments used by operators of public and private telecommunications networks for the installation, maintenance and optimization of advanced communications networks.

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

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 components, enable us to provide the following features and benefits to our customers:

DEVELOPMENT OF NEW SWITCH TECHNOLOGY. We have complemented our long-established range of products with a new range of patent-pending space-saving rotary switches we refer to as VLP(TM), 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 switches offered by our competitors.

PROVISION OF RF COMPONENTS AND SUBASSEMBLIES. We have developed and provide a range of RF components and subassemblies that meet the requirements of defense, aerospace and industrial applications.

DEVELOPMENT 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 more extensive RBOC market.

PROVISION OF MORE EFFICIENT AND COST-EFFECTIVE POWER SYSTEMS. We have developed and we provide 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 network access and transmission products that are 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 generally exceed the surge protection standards of the industry and are adaptive to wide ranges of AC or DC power inputs. The design of many of our data transmission products enables them to either interface with or complement one another. The versatility of this concept has enabled us to offer numerous different product combinations to our customers. These variations include customized selection of 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.

HANDHELD DESIGN OF FIELD TEST EQUIPMENT. We design many of our test equipment products to be used in the field. Most of our digital and analog products weigh less than four pounds and offer handheld convenience. The compact, lightweight design of these products enables field technicians to access problems and verify line operation quickly.

RAPID AND EFFICIENT DIGITAL SERVICES DEPLOYMENT. Our test equipment products allow field and office technicians to test lines rapidly and efficiently to ensure that they are properly connected to the central office and that they can support a specific type and speed of service. In a single device, our products can be used to pre-qualify facilities for services, identify the source of problems and verify the proper operation of newly installed service before handing service over to customers.

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 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 components are the best available solution for them. For example, based on conversations with 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 components business currently enjoys a preferred supplier status with several key accounts, which means that we work in close association with the customer to develop custom products specifically addressing their needs. Our electronic components also are considered qualified products with many key accounts, which means that our products are designed into equipment specifications of some of our customers for the duration of their

production of their equipment.

LONG-TERM RELATIONSHIPS. Market procurement methods encourage long-term relationships between electronic components 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' 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 and custom power supplies in the aerospace, defense and industrial markets, in addition to becoming a leading provider of network access and transmission products and communications test instruments 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 COMPONENTS BUSINESS. We plan to continue to grow our electronic components business by marketing our electronic components products in their established market niches, identifying opportunities to broaden our customer base for our power supply products and introducing RF components and subsystems offered by our newly acquired Pascall subsidiary.

RAMP UP OUR NEW COMMUNICATION TIMING AND SYNCHRONIZATION PRODUCTS AND CONTINUE TO FOCUS ON NETWORK ACCESS AND TRANSMISSION PRODUCTS. We plan to build upon our existing strong base businesses in the communications equipment market introducing additional new customer premises products, especially new carrier class communication timing and synchronization products, utilizing our broader reach with CXR Larus to address new markets.

PURSUE STRATEGIC ACQUISITIONS. The communication timing and synchronization products market and network access and transmission market are large and highly fragmented. We plan to extend our market position by acquiring or investing in complementary businesses or technologies on a selected basis. We also intend to expand our United Kingdom-based electronic power supplies division's United States presence through acquisition of businesses that offer complementary products or technology for manufacture in the United States. In this regard, we are currently in discussions to acquire a United States-based power supply company.

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 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 test equipment and generating follow-on sales opportunities as we develop new modules in the future. We plan to continue to approach our existing digital switch customers to determine whether they need rotary switches that we do not currently manufacture for them.

SEEK COMPETITIVE WORLD-CLASS MANUFACTURING IN ASIA FOR SELECTED PRODUCTS. Toward the end of 2002, we cut costs by using Asian manufacturing sources for selected communications equipment products and subassemblies. We intend to build on this strategy to increase our competitiveness in the marketplace.

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 test equipment.

DEVELOP AND ExPAND STRATEGIC RELATIONSHIPS. We plan to continue to develop our strategic relationships with network access and transmission and test instrument 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 as a provider of a comprehensive line of test equipment products.

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, as we did with the base platform for our remote access server products purchased from Hayes Corporation.

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 test and manage increasingly large and complex networks and that are easily used by field technicians and central office personnel.

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 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 Components
  - digital and rotary switches

  - electronic power supplies
  - RF components

- -- subsystem assemblies

- o Communications Equipment

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

During the years 2004, 2003 and 2002, our total net sales were $29,861,000, $25,519,000 and $22,664,000, respectively, and the percentages of total net sales contributed by each product group within our two main business segments were as follows:

Segment and Product Type	Year Ended December 31, 2004	2003	2002
Electronic Components			
Digital and Rotary Switches	18.5%	20.9%	20.9%
Electronic Power Supplies	26.7%	34.3%	31.3%
Subsystem Assemblies	0.7%	5.9%	5.0%
Other Products and Services	5.2%	2.3%	1.9%
	51.1%	63.4%	59.1%
Communications Equipment			
Network Access and Transmission Products	27.6%	24.0%	23.8%
Test Instruments	13.6%	9.2%	12.7%
Timing and Synchronization Products	4.3%	--	--
Other Products and Services	3.4%	3.4%	4.4%
	48.9%	36.6%	40.9%
Totals	100.0%	100.0%	100.0%

BACKLOG

Our business is not generally seasonal, with the exception that purchases of our communications equipment by telecommunications customers 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, 2004, our backlog of firm, unshipped orders was approximately $7.7 million. Our backlog was related approximately 82.3% to our electronic components business, which tends to provide us with long lead-times for our manufacturing processes due to the custom nature of the products, and 17.7% to our communications equipment business, the majority of which portion relates to our network access and transmission products. Of these backlog orders, we anticipate fulfilling approximately 80% of our electronic components 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 components, 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 components or other materials or workmanship will not arise in the future.

OUR ELECTRONIC COMPONENTS BUSINESS

Our electronic components segment includes digital and rotary switches, electronic power supplies, RF components and subsystem assemblies. During the years ended December 31, 2004, 2003 and 2002, this segment accounted for 51.1%, 63.4% and 59.1%, respectively, of our total net sales.

DIGITAL AND ROTARY SWITCHES

Digitran 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 wide variety of custom keypads and digital and rotary switches for unique applications.

Our switches may be ordered with different combinations of a variety of features and options, including:

- 8, 10, 11, 12, 16 or a special number of dial positions;
- special markings and dial characters;
- fully sealed, dust sealed or panel (gasket) sealed switch chambers to increase resistance to the elements in hostile environments, such as dust, sand, oils, salt spray, high humidity and temperature and explosive atmospheres;
- available with radio frequency interference shielding;
- rear mount (flush) or front mount switches that are sold with the needed installation hardware, or snap in mount switches that do not require installation hardware;
- provision for mounting components on output terminals on special personal computer boards;
- wire wrap terminals, pin terminals or special terminations;
- night vision compatibility;
- rotary; and
- VLP(TM) rotary.

ELECTRONIC POWER SUPPLIES

XPS and Pascall, based in England, manufacture a range of high and low voltage, high specification, high reliability custom power conversion products and RF components and subsystems designed for hostile environments and supplied to an international customer base, predominantly in the military and civil aerospace, military vehicle and telecommunications markets.

Power conversion units supplied by XPS and Pascall range from 10VA to 1.5 KVA power ratings, low voltage (1V) to high voltage (20KV+), and convert alternating current, or AC, to direct current, or DC, convert DC to AC and convert DC to AC. Units can be manufactured to satisfy input requirements determined by military, civil 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.

RF COMPONENTS

Pascall designs, develops, manufactures and markets a range of RF and microwave amplifiers, components, subsystems and systems to 18GHz for applications that include defense, aerospace, communications, air traffic control and weather radar.

SUBSYSTEM ASSEMBLIES

Subsystem assemblies incorporate various input and display devices and are manufactured for integration with various aerospace, defense, industrial and transportation industry systems.

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, 2004, 2003 and 2002, the sale of communications equipment products and related services accounted for 48.9%, 36.6% and 40.9%, respectively, of our total net sales. These products, many of which are described below, 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.

Some of the acronyms and terms used most frequently in the product discussions on the following pages include:

- Time division multiplexing, or TDM, which is a technique for consolidating multiple data sources into a single data stream by allocating time slots to each data source
- Traditional telephone services, such as modems and plain old telephone service, or POTS
- Competitive local exchange carriers, or CLECs
- Independent local exchange carriers, or ILECs
- Bit error rate test, or BERT
- Dial tone multi-frequency, or DTMF

- Transmission impairment measurement, or TIMS

- Central office and private business exchange, or CO/PBX, services, where the central office houses the local exchange equipment that routes calls to and from customers and to Internet service providers and long-distance carriers

- Synchronous - in digital telephone transmission, synchronous means that the bits from one call are carried within one transmission frame

- Digital data services, or DDS, including the USA and worldwide standards described below:

  I. USA standards, including:
    - ISDN, which is an enhanced digital network that offers more bandwidth and faster speed than the traditional telephone network
    - Caller identification or caller-ID services
    - Digital subscriber line technology, or DSL, technology which transmits data up to 50 times faster than a conventional dial-up modem using existing copper telephone wires
    - Multi-rate symmetric DSL, or MSDSL, which allows the transmission of data over longer distances than single-rate technologies by adjusting automatically or manually the transmission speed
    - T-1, which is a standard for digital transmission in North America used by large businesses for broadband access
    - FT-1, or fractional T-1, which uses only a selected number of channels from a T-1
    - T-3, which is the transmission rate of 44 megabits, or millions of bits, per second, or 44 Mbps, with 672 channels
    - Digital signal level 0, or DS0, which is 64 kilobits, or thousands of bits, per second, or 64 kbps, with one channel of a T-1, E-1, E-3 or T-3
    - Digital signal level 1, or DS1, which is the T-1 transmission rate of 1.54 Mbps, with 24 channels
    - Digital signal level 3, or DS3, which is the T-3 transmission rate of 44 Mbps, with 672 channels
    - Router, which is an intelligent device used to connect local and remote networks
    - Terminal adapter, which is situated between telephones or other devices and an ISDN line and allows multiple voice/data to share an ISDN line
    - Transmission control protocol/Internet protocol, or TCP/IP
    - STS/SONET, which is an acronym for synchronous transport signal/synchronous optical networks or fiber optic networks
    - SDH is an acronym for synchronous digital hierarchy
    - STM1 (SDH) is a standard technology for synchronous data transmission on optical media and is the international equivalent of synchronous optical network; SDH uses the following synchronous transport modules, or STMs, and rates: STM1- 155 Mbps, STM-4 - 622 Mbps, STM-16 - 2.5 gigabits per second (Gpbs), and STM-64 - 10 Gbps

- -- G703/G704 is a standard for transmitting voice over digital carriers such as T-1 and E-1; G703 provides the specifications for pulse code modulation at data rates from 64 Kbps to 2.048 Mbps and is typically used for interconnecting data communications equipment such as bridges, routers and multiplexers
- -- V11/V35/X21 are types of serial interfaces; serial interfaces work best for short (perhaps less than 20 meters), low-speed applications

- -- X.25 is a protocol that allows computers on different public networks or a TCP/IP network to communicate through an intermediary computer at the network layer level

II. International standards, including:

- -- E-1, which is the European standard for international digital transmission used by large businesses for broadband access, with 2.108 Mbps, with 30 channels
- -- FE-1, or fractional E-1, which uses only a selected number of channels from an E-1
- -- E-3, which is the European standard for T-3, with 34.368 Mbps and 480 channels

NETWORK ACCESS AND TRANSMISSION PRODUCTS

CXR Larus and CXR-AJ design, develop, manufacture and market a broad range of network access and transmission products. These products include high-quality network access devices such as fiber optic, DSL and voice frequency, or VF, modems, ISDN terminal adapters, ISDN concentrators, multiplexers, terminal servers, interface converters and remote access servers, which combine to provide users with a complete solution for voice and data transmission.

MODEMS

Our modem product range includes professional grade traditional VF modems covering the performance spectrum, a range of fiber optic modems and a range of DSL modems. Our modems are sold as standalone devices for remote sites or as rack-mountable versions for central sites. Our customers use our high-quality professional grade modems worldwide for networking and for central office telecommunications applications such as voicemail and billing systems and secure communications. Our modems are feature rich and we believe generally offer more capabilities and better performance than competing products, especially when operating over poor quality lines. This characteristic alone has made our modems the modems of choice for voicemail applications throughout the United States. Our modems are also available in more rugged versions for industrial applications such as telemetry and remote monitoring in harsh environments.

ISDN Terminal Adapters

Together with modems, we offer a line of ISDN terminal adapters, which are the popular digital equivalent of analog modems used primarily in Europe. These terminal adapters are used in a broad range of applications, including

point-of-sale and videoconferencing, and are available in standalone as well as rack-mountable versions.

TERMINAL SERVERS

Terminal servers include a range of products that enable the connection of asynchronous applications to the Ethernet Network. These products were designed to meet the requirements of our customers to interface equipment to the corporate local area network, commonly called the LAN, and therefore to the outside world, via our range of network access products.

DROP AND INSERT MULTIPLEXERS

Our broad range of drop and insert multiplexers covers E-1, T-1, FE-1, E-3, T-3 and STM1 (SDH) over both copper wires and fiber optic networks. The units enable users to manage the consolidation of their information from a variety of voice or data sources (G703, G704, X21, V11 and V35) through an easy-to-use menu-driven and Microsoft Windows-based user interface.

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MODULAR ROUTERS

Our commercial/industrial router product range is modular, which provides users the flexibility to configure or have configured a unit that meets their specific requirements. Our routers provide access to the Internet or remote sites via ISDN, leased line, X.25, frame relay and DSL connections. The router creates or maintains a table of available routes and their conditions and uses this information, along with distance and cost algorithms, to determine the best route for a given packet of data.

INTERFACE CONVERTERS

Our range of interface converters provides users the ability to interface data from LAN, V11 or V35 to E-1, T-1, E-3, T-3 and STM1. A channel service unit/data service unit, or CSU/DSU, converts a digital data frame from a LAN into a frame appropriate to a wide area network, or WAN.

ISDN CONCENTRATORS

We also manufacture and offer a line of ISDN intelligent concentrators called CB2000. These products, which were designed primarily for the European market, allow for better use of ISDN resources.

TDMOIP VOICE AND DATA TRANSMISSION

Our IP-Jet TDMoIP products facilitate the use of TDM services and equipment over the Packet Switched Network bringing simplicity with lower cost without the costly need to replace existing TDM hardware for both carrier and enterprise users. TDM over IP, or TDMoIP, takes advantage of the internet protocol, or IP, infrastructure and changing economics of data services delivery to deliver high revenue leased line services such as E1 and T1. TDMoIP is also ideal for the enterprise looking to reduce network expenses without compromising

features of their existing PBX and TDM equipment allowing all TDM traffic to be carried transparently over Ethernet and IP networks irrespective of protocols or signaling. Typical TDMoIP applications include: transmission of E1/T1, voice, video and TDM data and IP, centralized voice services over Ethernet or IP, secure data transmission E1/T1, and transmission of HDLC over IP.

The following are descriptions of a few of our more prominent network access and transmission products:

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
POWER MODEMS	A family of products that allow asynchronous and synchronous transmission over dial-up or leased lines; asynchronous transmission is a very high-speed transfer mode that allows telephone companies to mix formerly incompatible signals, such as voice, video and data. -- in dial-up applications, a unique line qualification mechanism assesses the quality of the line and automatically redials before entering the transmission mode when a poor line is detected, which avoids having to transmit in a degraded mode and leads to money savings in long transmission sessions -- available in standalone units or as rack mountable cards to be inserted into our Smart Rack -- industrial versions designed for harsh environments are available with features such as extra line protection, metallic enclosures, extended temperature ranges and high humidity protection

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
MD 2000 RANGE	A multi-rate MSDSL modem that has the ability to manually or automatically adjust line transmission speed to provide the optimum performance for a particular pair of copper wires. -- operates over a single twisted pair of copper wires, which allows telecommunications companies to take advantage of the large installed base of copper twisted pairs that has been deployed around the world over many years and upon private copper wire infrastructures that

exist for networking purposes in locations such as universities, hospitals, military bases, power plants and industrial complexes

-- allows data transmission over a single copper pair at E-1 speed over a distance of up to 8.0 miles

-- available as both a standalone unit and as a rack-mountable card

CB 2000 RANGE

The primary function of this unit is to split one or two primary rate interface links, or PRIs, into multiple basic rate interfaces, or BRIs.

-- this allows substantial cost savings by allowing more effective use of available ISDN resources without the limitations of conventional voice PBX

-- this allows for migration from BRI to PRI when the number of ports needs to be increased while preserving the user's investment in existing BRI-based terminal equipment

-- this unit can be used in a wide variety of situations where multiple BRI and PRI access is required, such as:

- videoconferencing, where the unit can be used to aggregate bandwidth of multiple BRI lines to provide the necessary bandwidth, and to connect the videoconferencing system to the ISDN network through a PRI access while still providing connectivity to other ISDN devices, or to connect two or more videoconferencing systems together within the same building or campus without going through the ISDN public network
- ISDN network simulation, which can be used in places such as showrooms, exhibition and technical training centers to eliminate the need to have access to, and pay for access to, the ISDN public network for telephone or data calls
- remote access servers, which usually use multiple BRIs, often need a method for migration from multiple BRIs to a single PRI as traffic and the number of users

	expands
ISDN TERMINAL ADAPTERS	These devices are the ISDN equivalent of a modem. -- these devices connect non-ISDN devices to the ISDN via a network termination unit, or NT1, which converts the "U" interface from the telephone company into a 4-wire S/T interface -- allow users to access the data rates of the digital network -- available as both a standalone unit and as a rack-mountable card
TERMINAL SERVERS	This range of products is used to provide the connection of asynchronous applications to the TCP/IP Ethernet network. These can include point-of-sale terminals, industrial machines, point-to-point RS232 connections and the visual display units/keyboards.
DROP AND INSERT MULTIPLEXERS	These products provide users the ability to manage the consolidation of data and/or voice information over a variety of TDM networks such as E-1, T-1, E-3, T-3 and STM (SDH). -- easily configured via management software -- remotely manageable over IP or dedicated time slot

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
ROUTERS	A router provides connection between the primary rate ISDN and local area networks. -- dynamically route incoming and outgoing data packets to the appropriate destination -- available as both a standalone unit and as a rack-mountable card to supplement the functions of our Smart Rack system

Smart Rack

Our modem cards and our ISDN terminal adapter cards generally are available in standalone versions or in versions that can be mounted in our Smart Rack, our universal card cage that provides remote management through a menu-driven user interface. Each part of the framework, or chassis, of the Smart Rack has slots to house up to 16 cards (or up to 4 cards in a smaller installation) plus one optional management card. Each slot can be used to insert any member of our transmission products family, such as analog modems, ISDN terminal adapters, ISDN digital modems and high-speed MSDSL modems. The optional Simple Network Management Protocol/Internet Protocol, or SNMP/IP, management

card that can be inserted into each chassis can be used to configure any card in the chassis and can provide additional features, including alarm reporting, tracking of configurations, running of diagnostic routines and generation of statistics. Up to eight chassis can be linked together to form a fully-managed node with 128 slots. Our Smart Rack arrangement allows each chassis to be used to its full capacity while reducing floor space needed to house complex systems.

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.

Some of the key communication timing and synchronization products we offer are described below:

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
STAR SYNCTM 5850 PRIMARY REFERENCE SOURCE	The Larus StarSync(TM) Model STS 5850 is an economical GPS timing clock designed for retrofits of existing BITS clocks and for remote sites that require timing. The StarSync(TM) provides GPS Stratum 2 clock with Stratum 2 or 3E holdover performance. The STS 5850 features two accurate T1 timing references that are synthesized from GPS for use by BITS clocks, SONET NEs, intelligent multiplexers, and PCS systems as well as other systems requiring synchronization. Options permit the STS 5850 to be configured for Stratum 1 Input

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
	Track and either Stratum 2 or Stratum 3E Hold. Superior performance is achieved by Kalman filtering, patented digital frequency synthesis technology, and use of GPS UTC information to measure a rubidium oscillator (Stratum 2) or an ultra stable

	ovenized reference oscillator (Stratum 3E).
STARCLOCKTM STS 5800 TIMING SYSTEM	The Larus StarClock(TM) STS 5800 Timing System provides GPS Stratum 1 clock and/or network tracking with Stratum 2 or Stratum 3E holdover performance. The Larus StarClock(TM) represents the optimal local synchronization solution for the new distributed network. The STS 5800 is an economical extended temperature timing system that is designed for small installations and remote sites requiring timing (cell sites, PCS networks, customer premises, etc.). The output MTIE of the STS 5800 meets the mask performance specified by GR-2830 for Stratum 1 clocks, resulting in an improvement of ten to twenty times over other GPS solutions.
STARCLOCKTM 100 AND STARCLOCKTM 200 T1/E1 SYNCHRONIZATION TIMING SYSTEMS	The innovative StarClockTM 100 and 200 Synchronization Timing Systems offers flexible and cost-effective solutions for Stratum 1, Stratum 2E, and Stratum 3E timing for digital transmission and synchronization applications. The systems provide a redundant and jitter-free source of framed ones and composite clock and are synchronized to an equal or higher stratum framed reference source. The StarClockTM 100 and 200 systems can be employed in either DS1 or E1 digital transmission environments simply by selecting the appropriate modules. The StarClockTM 100 and 200 systems are the next generation of Larus' industry-performance-standard STS 5400 Synchronization System and features backward compatibility with the STS 5400. StarClockTM 100 and 200 circuit card switch settings and operating functions are software generated, affording both speed and flexibility for system application changes, testing, and monitoring. The StarClockTM 100 system supplies up to 100 timing outputs for use in the synchronization of

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
	transmultiplexers, digital cross-connect systems, and SONET equipment as well as other equipment requiring network synchronization. Hundreds of these systems have been deployed into major local exchange carriers, and international central offices worldwide. The StarClockTM 200, designed specifically for the RBOC and large central office environment, offers up to 200 timing outputs unprotected, or 100 timing outputs with 1:1 protection. Expansion shelves can be added to the StarClockTM 200 system that will boost the number of timing outputs into the thousands, enough for the largest central office.

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
	Optional modules for both systems include a GPS Stratum 1 track and Stratum 2E hold or Stratum 1 track and Stratum 3E hold card, with integral GPS receiver, a Composite Input Signal module, a module that uses 5 or 10 MHz inputs, and the Model 54580 Network Time Server.

COMMUNICATIONS TEST INSTRUMENTS

Our primary field test instruments, built by CXR Larus, are our 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 and Internet companies to pre-qualify facilities for services, verify proper operation of newly installed services and diagnose problems. Original equipment manufacturers, or OEMs, also use service verification equipment to test simulated networks during equipment development and to verify the successful production of equipment.

The unique 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. Key performance enhancements to this product family address the trend toward conversion of analog service installations to high-speed digital access lines. Some of these key features include:

- ability to conduct the 23-tone test, which is an automated

single key-stroke test that performs the equivalent of over 12 individual test sequences;

- load-coil analysis, which identifies the presence of voice coils that prevent high-speed digital access; and
- voice analysis and testing of individual T-1 channels.

We believe that these enhancements will allow further penetration of CXR HALCYON 700 series test equipment into the telecommunications services market. Some of the key test equipment products we offer are described below:

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
	TYPICAL BASE UNIT
HALCYON 756A	-- handheld integrated test set for installation an of digital data circuits, including DDS, Switche Datapath, ISDN, T-1 and FT-1
	-- provides users with intuitive user interface all circuit diagnosis and repair without extensive t
	TYPICAL OPTIONAL CONFIGURATIONS
HALCYON 704A-NTS1	-- 704A universal data test set with 1.5 MHz TIMS, caller ID and full 4-wire loop DDS test function DDS/DS0 test functions and T-1, DS1, DS0 and FT-
	-- T-1 test package includes reference receiver for frequency and slip measurements

PRODUCT NAME	KEY USES, FEATURES AND FUNCTIONS
HALCYON 704A-NTS2	-- universal data test set
	-- handheld wideband test set for installation and analog voice and data and digital data circuits Switched 56K
	-- expands upon the features of the 704A-400 to add DS1/T-1/FT-1 test functions
HALCYON 704A-PKG2	-- 704A universal data test set with 1.5 MHz TIMS, full 4-wire loop DDS test functions, as well as functions for DS0-DP and OCU-DP DS0 and sub-rate
HALCYON 756A-PG	-- handheld integrated test set designed for the te performance monitoring of digital data communica "protective relaying backbone communications" fo companies
	-- provides users with a test set which closely emu operating conditions of the data links while pro intuitive user interface allowing quick circuit diagnosis and repair without extensive training
	CENTRAL OFFICE TEST EQUIPMENT

T-COM 440B T-ACE	This is a high-performance integrated digital communicat instrument. -- used to monitor and assure service reliability o digital test nodes and switch centers -- provides comprehensive digital test measurements STS/SONET, DS3, through T-1, FT-1, DSO and DDS s

CUSTOMERS

ELECTRONIC COMPONENTS

We sell our components primarily to OEMs in the electronics industry, including manufacturers of aerospace and defense systems and industrial instruments. During 2004, our top five electronic components customers in terms of revenues were the BAE Systems companies, MBDA (U.K.) Ltd., Teldix, Raytheon Corporation and L3 Communications. Sales to various BAE Systems companies in the Europe and the United States, as a group, represented approximately 14.6% of our total net sales revenues during 2004. No other customer represented 10% or more of our total net sales during 2004.

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 our telecommunications test instruments, network access and transmission products and services and communication timing and synchronization products include RBOCs, 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 2004, 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 Verizon, Siemens, SBC, Coris and Carte, SA. None of our communications equipment customers represented 10% or more of our revenues during 2004.

Because we currently derive a significant portion of our revenues from sales to RBOCs 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 the RBOCs. RBOCs generally obtain approval for their annual budgets during the first quarter of each calendar year. If an RBOC'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 RBOC during the period of the delay or shortfall.

Due to a general downturn in business activity in the public carrier telecommunications capital equipment market from 2000 to 2004, RBOCs reduced their capital expenditures, which negatively affected our 2002 and 2003 sales of test instruments. Our observance was that capital expenditure levels of RBOCs and other telecommunications carriers remained at reduced levels in 2003. However, we reduced costs and improved our business operations so that our current monthly break-even sales requirement is approximately 50% of our requirement in 2002. This, coupled with an increase in the sales of test equipment in the fourth quarter of 2004, resulted in improved sales of test instruments in 2004 as compared to 2003.

Communications equipment manufacturers design, develop, install and maintain voice, data and video communications equipment. Network equipment manufacturers such as Cisco and Nortel rely on our test equipment products to verify the proper functioning of their products during final assembly and testing. Increasingly, because communications service providers are choosing to outsource installation and maintenance functions to the equipment manufacturers themselves, equipment manufacturers are using our instruments, systems and software to assess the performance of their products during installation and maintenance of a customer's network.

In July 2004, we acquired Larus Corporation, a manufacturer of communication timing and synchronization products. The business formerly conducted by Larus Corporation contributed $3,424,000 in net sales from July through December 2004.

SALES, MARKETING AND CUSTOMER SUPPORT

ELECTRONIC COMPONENTS

We market and sell our electronic components through Digitran, XCEL Corporation Ltd., XPS, Pascall, and XCEL Japan, Ltd., a wholly-owned subsidiary of XET Corporation 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 components primarily to OEMs in the electronics industry, including manufacturers of aerospace and military systems and industrial instruments. Our efforts to market our electronic components generally are limited in scope since we rely on sales to a broad base of historical customers with whom we have long-term business dealings.

XCEL Japan, Ltd. resells Digitran's digital and rotary switch and keypad products and some third-party-sourced components primarily into Japan and also into other highly industrialized Asian countries. Marketing of our electronic components is primarily through referrals from our existing customers, with sales either direct or via a small number of selected 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. Also, Digitran's history spans over 40

years in the electronic components industry, and major OEMs have designed many of our switches, subsystem assemblies, power supplies and RF components into their 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 longstanding 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, our representatives' familiarity 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 communications 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 the 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 COMPONENTS

The market for our components is highly fragmented and composed of a diverse group of OEMs, including Power One, Interpoint/Grenson, Martek and Celab Ltd. for power supplies and Esterline (Janco), Greyhill, Inc., Omron Electronics, Transico Inc. and C&K Components Inc. for digital switches. We believe that the principal competitive factors affecting our components business include:

- capability and quality of product offerings;
- status as qualified products; and
- 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 components 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 us 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 and Oscilloquartz, for communication timing and synchronization products, RAD, Paradyne, Patton Electronics Corporation, Digital Engineering, Ltd. and GDC, for network access and transmission products, and TTC Corporation (a subsidiary of Dynatech Corporation), Ameritech Corporation, Fluke, Sunrise Telecom, Inc. and Electrodata, Inc., for communications test instruments.

The design of many of our data transmission products enables us to offer numerous different 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 RBOCs. We believe we derive a competitive advantage from efforts we expended to establish many of our communications equipment products as approved products for all of the RBOCs 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 us 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 components, with final assembly, configuration and quality testing performed in house.

Manufacturing of our electronic components, including injection molding, fabrication, machining, printed circuit board manufacturing and 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 components incorporate standard designs and specifications, products are built to customer order. This approach, which avoids the need to maintain a finished goods inventory, is possible because long lead-times for delivery often are available. Typically, our electronic components 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.

We operate five manufacturing and assembly facilities worldwide. All of these facilities are certified as ISO 9001- or 9002-compliant. We manufacture our network access and transmission products at CXR-AJ's facility in France and at CXR Larus' facility in San Jose, California. We manufacture RF components and subsystems at Pascall's facility in Ryde, Isle of Wight, England. 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 our Rancho Cucamonga, California facility. We manufacture our electronic power supplies in Ashford, Kent, 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 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, 2004, 2003 and 2002, our engineering and product development costs were approximately $1,521,000, $951,000 and $1,015,000, respectively.

Our product development costs during the past three years were related to development of new communications test equipment and voice, data and video transmission equipment and development of a new line of rotary switches at our Digitran facility. 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 enhancements to the current test instrument product line, the expansion of our range of network access and transmission products and the development and expansion of our range of Network Equipment Building System ("NEBS") qualified 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 components 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 filed patent applications, and intend to file additional patent applications in the future, for various products with the United States 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 test equipment products and transmission 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 affect on our business or financial condition.

EMPLOYEES

As of April 8, 2005, we employed approximately 335 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.

PROPERTIES

As of March 22, 2005, we leased or owned approximately 108,000 square feet of administrative, engineering, production, storage and shipping space. All of this space was leased other than the Abondant, France facility.

BUSINESS UNIT	LOCATION	FUNCTIO LEASE EXPIRAT
Emrise Corporation (corporate headquarters)	Rancho Cucamonga, California	Administration; Expires October
XET Corporation/Digitran (electronic components)	Rancho Cucamonga, California	Administration, Manufacturing; Expires November
	Monrovia, California	Expires February
XCEL Power Systems, Ltd. and XCEL Corporation Ltd. (electronic components)	Ashford, Kent, England	Administration, Manufacturing; E
XCEL Japan, Ltd. Higashi-Gotanda (electronic components)	Tokyo, Japan	Sales; Expires December
CXR-AJ (network access and transmission products)	Paris, France	Administration; Expires April 20
CXR-AJ (network access and transmission products)	Abondant, France	Administration, Manufacturing; Facility is owne
CXR Larus (network access and transmission products, communications test instruments, communication timing and synchronization products)	San Jose, California	Administration, Manufacturing; Expires June 201
Pascall Electronics Limited	Ryde, Isle of Wight, England	Administration, Manufacturing; Expires May 2016

On November 1, 2004, CXR Larus relocated from its Fremont facility to the facility in San Jose occupied by Larus Corporation at the time it was acquired in July 2004. Our lease on that facility expires June 30, 2011, with an option to renew.

Our lease for the Ashford, Kent, England facility is a fifteen-year lease that expires in March 2013, subject to the rights of the landlord or us to

terminate the lease after ten years.

We believe the listed facilities are adequate for our current business operations.

LEGAL PROCEEDINGS

We are not a party to any material legal proceedings.

MANAGEMENT

DIRECTORS AND EXECUTIVE OFFICERS

The names, ages and positions held by our directors and executive officers as of March 22, 2005 are as follows:

NAME	AGE	POSITIONS HELD
Carmine T. Oliva......................	62	Chairman of the Board, President, Chief Exec Officer and Director
Graham Jefferies......................	47	Executive Vice President, Chief Operating Of Managing Director of various subsidiaries
Randolph D. Foote.....................	56	Senior Vice President, Chief Financial Offic Secretary
Robert B. Runyon (1)(2)...............	79	Director
Laurence P. Finnegan, Jr. (1)(3).......	67	Director
Otis W. Baskin (3)....................	59	Director

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(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, XET Corporation, since he founded XET Corporation in 1983. Mr. Oliva has been Chairman of the Board of XCEL Corporation, 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/Business 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 XCEL Corporation, 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.

RANDOLPH D. FOOTE was appointed as our Senior Vice President and Chief Financial Officer on October 4, 1999 and as our Assistant Secretary on February 12, 2001. Mr. Foote has been our Secretary since September 2004 and the Vice President and Chief Financial Officer of CXR Larus and XET Corporation since March 2000. Mr. Foote was the Corporate Controller of Unit Instruments, Inc., a publicly traded semiconductor equipment manufacturer, from October 1995 to May 1999. From March 1985 to October 1995, Mr. Foote was the Director of Tax and Financial Reporting at Optical Radiation Corporation, a publicly traded company that designed and manufactured products using advanced optical technology. Prior to 1985, Mr. Foote held positions with Western Gear Corporation and Bucyrus Erie Company, which were both publicly traded companies. Mr. Foote earned a B.S. degree in Business Management from California State Polytechnic University, Pomona and an M.B.A. degree in Tax/Business from Golden Gate University.

ROBERT B. RUNYON has served as a Class III director since March 26, 1997 and also served as our Secretary from that date through August 2004. He has been the owner and principal of Runyon and Associates, a human resources and business advisory firm, since 1987. He has acted as Senior Vice President of Sub Hydro Dynamics Inc., a privately held marine services company based in Hilton Head, South Carolina, since September 1995. Prior to our merger with XET Corporation, Mr. Runyon served XET Corporation both as a director since August 1983 and as a consultant in the areas of strategy development and business planning, organization, human resources and administrative systems. He also consults for companies in environmental products, marine propulsion systems and architectural services sectors in these same areas. From 1970 to 1978, Mr. Runyon held various executive positions with ITT Corporation, including Vice President, Administration of ITT Grinnell, a manufacturing subsidiary of ITT. From 1963 to 1970, Mr. Runyon held executive positions at BP Oil including Vice President, Corporate Planning and Administration of BP Oil Corporation, and Director, Organization and Personnel for its predecessor, Sinclair Oil Corporation. Mr. Runyon was Executive Vice President, Human Resources at the Great Atlantic & Pacific Tea Company from 1978 to 1980. Mr. Runyon earned a B.S. degree in Economics/Industrial Management from University of Pennsylvania.

LAURENCE P. FINNEGAN, JR. has served as a Class II director since March 26, 1997. In addition to being a director of XET Corporation from 1985 to March 1997, Mr. Finnegan was XET Corporation's 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 by the University of Houston, and a B.A. degree in Religion from Oklahoma Christian University.

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 2006 annual meeting, one Class II director whose term expires at our 2007 annual meeting, and two Class III directors whose term expires at our 2005 annual meeting.

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 Securities Exchange Act of 1934, as amended ("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 Securities and Exchange Commission ("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, 2004 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 2004, all Section 16(a) filing requirements applicable to our reporting persons were met, except that Otis Baskin filed a late Form 3 to report his becoming a reporting person.

CODE OF ETHICS

Our board of directors has adopted a 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 intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K relating to amendments to or waivers from provisions 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 prospectus or incorporated into any other filings we make with the Commission.

COMPENSATION OF EXECUTIVE OFFICERS

The following table provides information concerning the annual and long-term compensation for the years ended December 31, 2004, 2003 and 2002 earned for services in all capacities as an employee by our Chief Executive Officer and each of our other executive officers who received an annual salary and bonus of more than $100,000 for services rendered to us during 2004 (collectively, the "named executive officers"):

SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION		ANNUAL COMPENSATION		LONG-TERM COMPENSATION AWA
	YEAR	SALARY	BONUS	SECURITIES UNDERLYING OPTIO
Carmine T. Oliva .... President and Chief Executive Officer	2004	$309,000	$94,000	26,000
	2003	$271,510	$70,000	53,000
	2002	$257,010	--	--
Graham Jefferies	2004	$237,017	$71,000	40,000

Executive Vice President and Chief Operating Officer (2)				
	2003	$210,295	$55,000	54,000
	2002	$156,923	--	--
Randolph D. Foote........................	2004	$173,867	$40,000	25,000
Senior Vice President, Chief Financial Officer and Assistant Secretary(4)				
	2003	$157,230	$30,000	35,000
	2002	$151,368	--	--

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(1) Represents the dollar value of insurance premiums we paid with respect to a $1,000,000 term life insurance policy for the benefit of Mr. Oliva's spouse.

(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 conversion rates in effect during the time periods of compensation. Mr. Jefferies served as Chief Operating Officer of our Telecommunications Group until he was appointed Chief Operating Officer of Emrise in January 2005.

(3) Represents company contributions to Mr. Jefferies' retirement account.

(4) Represents company contributions to Mr. Foote's 401(k) retirement account.

RETIREMENT ACCOUNT MATCHING CONTRIBUTIONS

We match up to the lesser of $2,000 and 20% of Mr. Foote's contributions to his 401(k) account. During 2004, our matching contribution amounted to $1,965. This matching arrangement was generally made available to all employees of Emrise and provides for the same method of allocation of benefits between management and non-management participants.

Also, 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 used to purchase annuities upon retirement. During 2004, 2003 and 2002, Mr. Jefferies received matching contributions of $10,924, $10,320 and $9,000, respectively.

OPTION GRANTS IN LAST FISCAL YEAR

The following table provides information regarding options granted in the year ended December 31, 2004 to the executive officers named in the summary compensation table. We did not grant any stock appreciation rights during 2004. This information includes hypothetical potential gains from stock options granted in 2004. These hypothetical gains are based entirely on assumed annual growth rates of 5% and 10% in the value of our common stock price over the ten-year life of the stock options granted in 2004. These assumed rates of growth were selected by the Commission for illustrative purposes only and are not intended to predict future stock prices, which will depend upon market conditions and our future performance and prospects.

NAMED OFFICER	GRANT DATE	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED(1)	PERCENTAGE OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR(2)	EXERCISE PRICE PER SHARE	EXPIRATION DATE
Carmine T. Oliva.......	2/24/04	26,000	8.3%	$1.00	2/24/14
Graham Jefferies.......	2/24/04	40,000	12.7%	$1.00	2/24/14
Randolph D. Foote......	2/24/04	25,000	7.9%	$1.00	2/24/14

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(1) Options vest in two equal annual installments commencing February 24, 2005.
(2) Based on options to purchase 314,698 shares granted to our employees during 2004.
(3) Calculated using the potential realizable value of each grant.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

The following table provides information regarding the value of unexercised options held by the named executive officers as of December 31, 2004. None of the named executives officers acquired shares through the exercise of options during 2004.

NAME	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT DECEMBER 31, 2004		VALUE ($) IN-THE-MON DECEMBER
	EXERCISABLE	UNEXERCISABLE	EXERCISABLE
Carmine T. Oliva..................	283,663	26,000	179,360
Graham Jefferies..................	180,287	40,000	168,480
Randolph D. Foote.................	85,000	25,000	115,450

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(1) Based on the last reported sale price of our common stock of $1.62 on December 30, 2004 (the last trading day during 2004) as reported on the OTC Bulletin Board, less the exercise price of the options.

EMPLOYMENT CONTRACTS AND TERMINATION OF EMPLOYMENT AND CHANGE-IN-CONTROL ARRANGEMENTS

CARMINE T. OLIVA

As of January 1, 2001, we entered into an employment agreement with Carmine T. Oliva, our Chairman of the Board, President and Chief Executive Officer. The agreement is subject to automatic renewal for two consecutive two-year terms beginning on January 1, 2006, unless, during the required notice periods (which run from September 1 to November 1 of the second year preceding the year in which a two-year renewal period is to begin), either party gives written notice of its desire not to renew. The agreement provides for an initial

base salary of $250,000 per year and states that Mr. Oliva is eligible to receive merit or promotional increases and to participate in other benefit and incentive programs we may offer. For 2004, Mr. Oliva's salary and car allowance totaled $309,000 and his bonus was $94,000.

If the board of directors makes a substantial addition to or reduction of Mr. Oliva's duties, Mr. Oliva may resign upon written notice given within 30 days of the change in duties. Within 30 days after the effective date of a resignation under these circumstances, we will be obligated to pay to Mr. Oliva the value of three years of his annual salary or the value of his annual salary that would have been due through January 1, 2006, whichever is greater.

If we terminate Mr. Oliva for cause, our obligation to pay any further compensation, severance allowance, or other amounts payable under the agreement terminates on the date of termination. If we terminate Mr. Oliva without cause (including by ceasing our operations due to bankruptcy or by our general inability to meet our obligations as they become due), we must provide him with 60 days' prior written notice. If the termination without cause occurs prior to the expiration of the initial term of the agreement on December 31, 2005, Mr. Oliva will be entitled to be paid his annual salary for three years following the termination or until December 31, 2005, whichever is the longer period. If the termination occurs during a renewal period, Mr. Oliva will be entitled to be paid his annual salary through the expiration of the particular renewal period or for two years, whichever is the longer period, and to be paid all other amounts payable under the agreement.

We may terminate the agreement upon 30 days' written notice in the event of a merger or reorganization in which our stockholders immediately prior to the merger or reorganization receive less than 50% of the outstanding voting shares of the successor corporation and in the event of a sale of all or substantially all of our assets or a sale, exchange or other disposition of two-thirds or more of our outstanding capital stock. If Mr. Oliva is terminated without cause within two years following a change of control, then:

- if the termination occurs prior to the expiration of the initial term of the agreement on December 31, 2005, Mr. Oliva will be entitled to be paid his annual salary and all other amounts payable under the agreement for three years following the termination or until December 31, 2005, whichever is the longer period, which amounts shall be payable at his election in a lump sum within 30 days after the termination or in installments;

- if the termination occurs during a renewal period, Mr. Oliva will be entitled to be paid his annual salary through the period ending two years after the expiration of the particular renewal period, and to be paid all other amounts payable under the agreement;

- Mr. Oliva will be entitled to receive the average of his annual executive bonuses awarded to him in the three years preceding his termination, over the same time span and under the same conditions as his annual salary;

- Mr. Oliva will be entitled to receive any executive bonus awarded but not yet paid;

- Mr. Oliva will be entitled to receive a gross up of all compensatory payments listed above so that he receives those payments substantially free of federal and state income taxes; and

- Mr. Oliva will continue to receive coverage in all benefit programs in which he was participating on the date of his termination until the earlier of the end of the initial term or renewal term in which the termination occurred and the date he receives equivalent coverage and benefits under plans and programs of a subsequent employer.

If Mr. Oliva dies during the term of the agreement, amounts payable under the agreement to or for the benefit of Mr. Oliva will continue to be payable to Mr. Oliva's designee or legal representatives for two years following his death. If Mr. Oliva is unable to substantially perform his duties under the agreement for an aggregate of 180 days in any 18-month period, we may terminate the agreement by ten days' prior written notice to Mr. Oliva following the 180th day of disability. However, we must continue to pay amounts payable under the agreement to or for the benefit of Mr. Oliva for two years following the effective date of the termination.

If the agreement is terminated for any reason and unless otherwise agreed to by Mr. Oliva and us, then in addition to any other severance payments to which Mr. Oliva is entitled, we must continue to pay Mr. Oliva's annual salary until:

- all obligations incurred by Mr. Oliva on our behalf, including any lease obligations signed by Mr. Oliva related to the performance of his duties under the agreement, have been voided or fully assumed by us or our successor;

- all loan collateral pledged by Mr. Oliva has been returned to Mr. Oliva; and

- all personal guarantees given by Mr. Oliva or his family on our behalf are voided.

The agreement provides that we will furnish a life insurance policy on Mr. Oliva's life, in the amount of $1 million, payable to Mr. Oliva's estate in the event of his death during the term of the agreement and any renewals of the agreement. This benefit is in return for, and is intended to protect Mr. Oliva's estate from financial loss arising from any and all personal guarantees that Mr. Oliva provided in favor of us, as required by various corporate lenders. This benefit is also intended to enable Mr. Oliva's estate to exercise all warrants and options to purchase shares of our common stock.

The agreement contains non-competition provisions that prohibit Mr. Oliva from engaging or participating in a competitive business or soliciting our customers or employees during the initial term and any renewal terms and for two years afterward if termination is for cause or for one year afterward if termination is without cause or following a change of control. The agreement also contains provisions that restrict disclosure by Mr. Oliva of our confidential information and assign ownership to us of inventions created by Mr. Oliva in connection with his employment.

RANDOLPH D. FOOTE

On July 2, 2001, we entered into an employment agreement with Randolph D. Foote at an initial annual salary of $130,000 and with an initial term of three years. For 2004, Mr. Foote's salary and car allowance totaled $174,000, and his bonus was $40,000. The agreement automatically renewed for a one-year

term on July 2, 2004 and is scheduled to automatically renew for one additional one-year term on July 2, 2005. Mr. Foote is to act as Senior Vice President and Chief Financial Officer and is to perform additional services as may be approved by our board of directors.

If the board of directors makes a substantial addition to or reduction of Mr. Foote's duties, Mr. Foote may resign upon written notice given within 30 days of the change in duties. Within 30 days after the effective date of a resignation under these circumstances, we will be obligated to pay to Mr. Foote the value of one year of his annual salary within 30 days after the effective date of the resignation.

If we terminate Mr. Foote for cause, our obligation to pay any further compensation, severance allowance, or other amounts payable under the agreement terminates on the date of termination. If we terminate Mr. Foote without cause (including by ceasing our operations due to bankruptcy or by our general

inability to meet our obligations as they become due), we must provide him with 60 days' prior written notice. Mr. Foote will be entitled to be paid his annual salary through the expiration of the then current renewal period, and to be paid all other amounts payable under the agreement.

We may terminate the agreement upon 30 days' written notice in the event of a merger or reorganization in which our stockholders immediately prior to the merger or reorganization receive less than 50% of the outstanding voting shares of the successor corporation and in the event of a sale of all or substantially all of our assets or a sale, exchange or other disposition of two-thirds or more of our outstanding capital stock. If Mr. Foote is terminated without cause within two years following a change of control, then:

- Mr. Foote will be entitled to be paid in installments or, at his election in a lump sum within 30 days after termination, his annual salary and other amounts payable under the agreement through the expiration of the then current renewal period plus one additional year;

- Mr. Foote will be entitled to receive the average of his annual executive bonuses awarded to him in the three years preceding his termination, over the same time span and under the same conditions as his annual salary;

- Mr. Foote will be entitled to receive any executive bonus awarded but not yet paid; and

- Mr. Foote will continue to receive coverage in all benefit programs in which he was participating on the date of his termination until the earlier of the end of the initial or current renewal term and the date he receives equivalent coverage and benefits under plans and programs of a subsequent employer.

If Mr. Foote dies during the term of the agreement, amounts payable under the agreement to or for the benefit of Mr. Foote will continue to be payable to Mr. Foote's designee or legal representatives for one year following his death. If Mr. Foote is unable to substantially perform his duties under the agreement for an aggregate of 180 days in any 18-month period, we may terminate the agreement by ten days' prior written notice to Mr. Foote following the 180th

day of disability; provided, however, that we must continue to pay amounts payable under the agreement to or for the benefit of Mr. Foote for one year following the effective date of the termination.

The agreement contains non-competition provisions that prohibit Mr. Foote from engaging or participating in a competitive business or soliciting our customers or employees during the initial term and any renewal terms and for one year afterward. The agreement also contains provisions that restrict disclosure by Mr. Foote of our confidential information and assign ownership to us of inventions created by Mr. Foote in connection with his employment.

GRAHAM JEFFERIES

On July 2, 2001, we entered into an employment agreement with Graham Jefferies at an initial annual salary of 100,000 British pounds sterling (approximately $141,000 at the then current exchange rates) and with an initial term of three years. For 2004, Mr. Jefferies' salary and car allowance totaled approximately 130,000 British pounds sterling (approximately $237,000 at the exchange rates applicable during 2004) and his bonus was 37,000 British pounds sterling (approximately $71,000 at the exchange rate in effect at December 31, 2004). The agreement automatically renewed for a one-year term on July 2, 2004 and is scheduled to automatically renew for one additional one-year term on July 2, 2005. Mr. Jefferies is to act as Managing Director of XCEL Corporation, Ltd. and as Executive Vice President and Chief Operating Officer of our Telecom Group

and is to perform additional services as may be approved by our board of directors. He was appointed as Chief Operating Officer of Emrise in January 2005. This agreement replaced a substantially similar agreement that had been effective since May 1, 1998.

If the board of directors makes a substantial addition to or reduction of Mr. Jefferies' duties, Mr. Jefferies may resign upon written notice given within 30 days of the change in duties. Within 30 days after the effective date of a resignation under these circumstances, we will be obligated to pay to Mr. Jefferies the value of one year of his annual salary within 30 days after the effective date of the resignation.

If we terminate Mr. Jefferies for cause, our obligation to pay any further compensation, severance allowance, or other amounts payable under the agreement terminates on the date of termination. If we terminate Mr. Jefferies without cause (including by ceasing our operations due to bankruptcy or by our general inability to meet our obligations as they become due), we must provide him with 60 days' prior written notice. Mr. Jefferies will be entitled to be paid his annual salary through the expiration of the then current renewal period plus one additional year, and to be paid all other amounts payable under the agreement.

We may terminate the agreement upon 30 days' written notice in the event of a merger or reorganization in which our stockholders immediately prior to the merger or reorganization receive less than 50% of the outstanding voting shares of the successor corporation and in the event of a sale of all or substantially all of our assets or a sale, exchange or other disposition of two-thirds or more of our outstanding capital stock. If Mr. Jefferies is terminated without cause within two years following a change of control, then:

o Mr. Jefferies will be entitled to be paid in installments or, at his election in a lump sum within 30 days after

termination, his annual salary and other amounts payable under the agreement through the expiration of the current renewal period plus one additional year;

- Mr. Jefferies will be entitled to receive the average of his annual executive bonuses awarded to him in the three years preceding his termination, over the same time span and under the same conditions as his annual salary;

- Mr. Jefferies will be entitled to receive any executive bonus awarded but not yet paid; and

- Mr. Jefferies will continue to receive coverage in all benefit programs in which he was participating on the date of his termination until the earlier of the end of the initial or current renewal term and the date he receives equivalent coverage and benefits under plans and programs of a subsequent employer.

If Mr. Jefferies dies during the term of the agreement, amounts payable under the agreement to or for the benefit of Mr. Jefferies will continue to be payable to Mr. Jefferies' designee or legal representatives for one year following his death. If Mr. Jefferies is unable to substantially perform his duties under the agreement for an aggregate of 180 days in any 18-month period, we may terminate the agreement by ten days' prior written notice to Mr. Jefferies following the 180th day of disability; provided, however, that we must continue to pay amounts payable under the agreement to or for the benefit of Mr. Jefferies for one year following the effective date of the termination.

The agreement contains non-competition provisions that prohibit Mr. Jefferies from engaging or participating in a competitive business or soliciting our customers or employees during the initial term and any renewal terms and for two years afterward if termination is for cause or for one year afterward if

termination is without cause or following a change of control. 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.

BOARD COMMITTEES

Our board of directors currently has an audit committee, a compensation committee and a nominating committee. Our board of directors has determined that Robert Runyon, Otis Baskin and Laurence Finnegan, each of whom is a member of one or more of these committees, are "independent" as defined in NASD Marketplace Rule 4200(a)(15) and that Messrs. Finnegan and Baskin meet the other criteria contained in NASD Marketplace Rule 4350 relating to audit committee members.

The audit committee selects our independent auditors, reviews the results and scope of the audit and other services provided by our independent auditors, and reviews our financial statements for each interim period and for our year end. From June 26, 1999 to March 21, 2004, this committee consisted of Laurence Finnegan. Since March 22, 2004, this committee has consisted of Mr. Finnegan, who serves as chairman, and Otis Baskin. The audit committee operates pursuant to a charter approved by our board of directors and audit committee. Our board of directors has determined that Mr. Finnegan is an "audit committee

financial expert."

The compensation committee is responsible for establishing and administering our policies involving the compensation of all of our executive officers and establishing and recommending to our board of directors the terms and conditions of all employee and consultant compensation and benefit plans. Our entire board of directors also may perform these functions with respect to our employee stock option plans. Since June 26, 1999, this committee has consisted of Messrs. Runyon and Finnegan. The compensation committee operates pursuant to a charter approved by our board of directors and compensation committee.

The nominating committee selects nominees for the board of directors. Beginning in and since 2000, the nominating committee has consisted of Mr. Runyon. There is one vacancy on the nominating committee. The nominating committee utilizes a variety of methods for identifying and evaluating nominees for director, including candidates that may be referred by stockholders. Stockholders that desire to recommend candidates for the board for evaluation may do so by contacting Emrise in writing, identifying the potential candidate and providing background information. Candidates may also come to the attention of the nominating committee through current board members, professional search firms and other persons. The nominating committee operates pursuant to a charter approved by our board of directors and Nominating Committee.

COMPENSATION OF DIRECTORS

During 2004, each non-employee director was entitled to receive $1,000 per month as compensation for his services. In addition, since November 1, 2002, each board member chairing a standing committee has been 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 February 24, 2004, we granted to each of Messrs. Runyon and Finnegan an option to purchase up to 30,000 shares of our common stock at an exercise price of $1.00 per share. The options vest in two equal installments on February 24, 2005 and February 24, 2006. In addition, we granted to Mr. Baskin, our newly-appointed non-employee director, an option to purchase up to 50,000 shares of our common stock upon the same terms as the options granted to the other two non-employee directors.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

No member of the board of directors has a relationship that would constitute an interlocking relationship with executive officers and directors of another entity. During 2004, Mr. Oliva made salary recommendations to our compensation committee regarding salary increases for key executives.

STOCK OPTION PLANS

We currently have four stock option plans: the 1993 Stock Option Plan, the Employee Stock and Stock Option Plan, the 1997 Stock Incentive Plan and the Amended and Restated 2000 Stock Option Plan ("2000 Stock Option Plan"). These plans are administered by our compensation committee, which currently consists of Messrs. Runyon and Finnegan.

The 1993 Stock Option Plan authorizes the issuance of incentive stock options, commonly known as ISOs, and non-qualified stock options, commonly known

as NQOs, to our employees and independent contractors for the purchase of up to 300,000 shares of our common stock. The 1993 Stock Option Plan terminated on August 31, 2003.

The Employee Stock and Stock Option Plan authorizes the issuance of NQOs and restricted and unrestricted stock grants to our employees (including officers and directors who are employees) and consultants for up to an aggregate of 520,000 shares of common stock. The Employee Stock and Stock Option Plan terminated on July 1, 2004.

The 1997 Stock Incentive Plan authorizes the issuance of ISOs, stock appreciation rights or stock awards to our employees and directors for up to an aggregate of 1,600,000 shares of common stock, except that ISOs may not be granted to non-employee directors. Our board of directors' adoption of the 1997 Stock Incentive Plan was ratified by our stockholders at our 1998 annual meeting of stockholders. The 1997 Stock Incentive Plan terminates on June 15, 2007. Our board does not intend to issue any additional options under the 1997 Stock Incentive Plan.

Our 2000 Stock Option Plan was adopted by our board of directors in November 2000, approved by our stockholders on January 16, 2001, and amended and restated by our board of directors in August 2001. The 2000 Stock Option Plan authorizes the issuance of ISOs and NQOs to our employees, officers, directors and consultants and to employees of companies that do business with us for the purchase of up to 2,000,000 shares of common stock. As of March 22, 2005, we had approximately 339 employees, officers and directors eligible to receive options under the 2000 Stock Option Plan, options to purchase up to 1,027,552 shares were outstanding under this plan and 868,698 shares remained available for grants under this plan. The following is a description of some of the key terms of the 2000 Stock Option Plan.

SHARES SUBJECT TO THE 2000 STOCK OPTION PLAN

A total of 2,000,000 shares of our common stock are authorized for issuance under the 2000 Stock Option Plan. Any shares of common stock that are subject to an award but are not used because the terms and conditions of the award are not met, or any shares that are used by participants to pay all or part of the purchase price of any option, may again be used for awards under the 2000 Stock Option Plan.

ADMINISTRATION

It is the intent of the 2000 Stock Option Plan that it be administered in a manner such that option grants and exercises would be "exempt" under Rule 16b-3 of the Exchange Act. The compensation committee is empowered to select those eligible persons to whom options shall be granted under the 2000 Stock

Option Plan; to determine the time or times at which each option shall be granted, whether options will be ISOs or NQOs and the number of shares to be subject to each option; and to fix the time and manner in which each option may be exercised, including the exercise price and option period, and other terms and conditions of options, all subject to the terms and conditions of the 2000 Stock Option Plan. The compensation committee has sole discretion to interpret and administer the 2000 Stock Option Plan, and its decisions regarding the 2000 Stock Option Plan are final, except that our board of directors can act in place of the compensation committee as the administrator of the 2000 Stock Option Plan at any time or from time to time, in its discretion.

OPTION TERMS

ISOs granted under the 2000 Stock Option Plan must have an exercise price of not less than 100% of the fair market value of a share of common stock on the date the ISO is granted and must be exercised, if at all, within ten years from the date of grant. In the case of an ISO granted to an optionee who owns more than 10% of the total voting securities of Emrise on the date of grant, the exercise price may be not less than 110% of fair market value on the date of grant, and the option period may not exceed five years. NQOs granted under the 2000 Stock Option Plan must have an exercise price of not less than 85% of the fair market value of a share of common stock on the date the NQO is granted.

Options may be exercised during a period of time fixed by the committee except that no option may be exercised more than ten years after the date of grant. In the discretion of the committee, payment of the purchase price for the shares of stock acquired through the exercise of an option may be made in cash, shares of our common stock or a combination of cash and shares of our common stock.

AMENDMENT AND TERMINATION

The 2000 Stock Option Plan may be wholly or partially amended or otherwise modified, suspended or terminated at any time and from time to time by our board of directors. However, our board of directors may not materially impair any outstanding options without the express consent of the optionee or materially increase the number of shares subject to the 2000 Stock Option Plan, materially increase the benefits to optionees under the 2000 Stock Option Plan, materially modify the requirements as to eligibility to participate in the 2000 Stock Option Plan or alter the method of determining the option exercise price without stockholder approval. No option may be granted under the 2000 Stock Option Plan after November 14, 2010.

FEDERAL INCOME TAX CONSEQUENCES

NQOs. Holders of NQOs do not realize income as a result of a grant of the option, but normally realize compensation income upon exercise of an NQO to the extent that the fair market value of the shares of common stock on the date of exercise of the NQO exceeds the exercise price paid. We will be required to withhold taxes on ordinary income realized by an optionee upon the exercise of a NQO.

In the case of an optionee subject to the "short-swing" profit recapture provisions of Section 16(b) of the Exchange Act, the optionee realizes income only upon the lapse of the six-month period under Section 16(b), unless the optionee elects to recognize income immediately upon exercise of his or her option.

ISOs. Holders of ISOs will not be considered to have received taxable income upon either the grant of the option or its exercise. Upon the sale or other taxable disposition of the shares, long-term capital gain will normally be recognized on the full amount of the difference between the amount realized and the option exercise price paid if no disposition of the shares has taken place within either two years from the date of grant of the option or one year from

the date of transfer of the shares to the optionee upon exercise. If the shares

are sold or otherwise disposed of before the end of the one-year or two-year periods, the holder of the ISO must include the gain realized as ordinary income to the extent of the lesser of the fair market value of the option stock minus the option price, or the amount realized minus the option price. Any gain in excess of these amounts, presumably, will be treated as capital gain. We will be entitled to a tax deduction in regard to an ISO only to the extent the optionee has ordinary income upon the sale or other disposition of the option shares.

Upon the exercise of an ISO, the amount by which the fair market value of the purchased shares at the time of exercise exceeds the option price will be an "item of tax preference" for purposes of computing the optionee's alternative minimum tax for the year of exercise. If the shares so acquired are disposed of prior to the expiration of the one-year or two-year periods described above, there should be no "item of tax preference" arising from the option exercise.

POSSIBLE ANTI-TAKEOVER EFFECTS

Although not intended as an anti-takeover measure by our board of directors, one of the possible effects of the 2000 Stock Option Plan could be to place additional shares, and to increase the percentage of the total number of shares outstanding, in the hands of the directors and officers of Emrise. Those persons may be viewed as part of, or friendly to, incumbent management and may, therefore, under some circumstances be expected to make investment and voting decisions in response to a hostile takeover attempt that may serve to discourage or render more difficult the accomplishment of the attempt.

In addition, options may, in the discretion of the committee, contain a provision providing for the acceleration of the exercisability of outstanding, but unexercisable, installments upon the first public announcement of a tender offer, merger, consolidation, sale of all or substantially all of our assets, or other attempted changes in the control of Emrise. In the opinion of our board of directors, this acceleration provision merely ensures that optionees under the 2000 Stock Option Plan will be able to exercise their options as intended by the board of directors and stockholders prior to any extraordinary corporate transaction which might serve to limit or restrict that right. Our board of directors is, however, presently unaware of any threat of hostile takeover involving Emrise.

INDEMNIFICATION OF DIRECTORS AND OFFICERS

Section 145 of the Delaware General Corporation Law permits a corporation to indemnify its directors and officers against expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred in connection with a pending or completed action, suit or proceeding if the officer or director acted in good faith and in a manner the officer or director reasonably believed to be in the best interests of the corporation.

Our certificate of incorporation provides that, except in certain specified instances, our directors shall not be personally liable to us or our stockholders for monetary damages for breach of their fiduciary duty as directors, except liability for the following:

- Any breach of their duty of loyalty to our company or our stockholders.
- Acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law.
- Unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law.

- o Any transaction from which the director derived an improper personal benefit.

In addition, our certificate of incorporation and bylaws obligate us to indemnify our directors and officers against expenses and other amounts reasonably incurred in connection with any proceeding arising from the fact that such person is or was an agent of ours. Our bylaws also authorize us to purchase and maintain insurance on behalf of any of our directors or officers against any liability asserted against that person in that capacity, whether or not we would have the power to indemnify that person under the provisions of the Delaware General Corporation Law. We have entered and expect to continue to enter into agreements to indemnify our directors and officers as determined by our board of directors. These agreements provide for indemnification of related expenses including attorneys' fees, judgments, fines and settlement amounts incurred by any of these individuals in any action or proceeding. We believe that these bylaw provisions and indemnification agreements are necessary to attract any retain qualified persons as directors and officers. We also maintain directors' and officers' liability insurance.

The limitation of liability and indemnification provisions in our certificate of incorporation and bylaws may discourage stockholders from bringing and lawsuit against our directors for breach of their fiduciary duty. They may also reduce the likelihood of derivative litigation against our directors and officers, even though an action, if successful, might benefit us and other stockholders. Furthermore, a stockholder's investment may be adversely affected to the extent that we pay the costs of settlement and damage awards against directors and officers as required by these indemnification provisions. At present, there is no pending litigation or proceeding involving any of our directors, officers or employees regarding which indemnification is sought, and we are not aware of any threatened litigation that may result in claims for indemnification.

We have entered into an indemnification agreement with each of our directors and executive officers. The indemnification agreements require us to indemnify our directors and officers to the fullest extent permitted by Delaware law.

Insofar as the provisions of our certificate of incorporation or bylaws provide for indemnification of directors or officers for liabilities arising under the Securities Act of 1933, as amended ("Securities Act"), we have been informed that in the opinion of the Commission this indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

We are or have been a party to employment and compensation arrangements with related parties, as more particularly described above under the headings "Compensation of Executive Officers," "Employment Contracts and Termination of Employment and Change-in-Control Arrangements" and "Compensation of Directors."

We have entered into an indemnification agreement 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.

As described below under the heading "Private Placements Through Which the Selling Security Holders Obtained Beneficial Ownership of the Offered

Shares," we issued in a January 2005 private placement common stock and warrants to investors who thereby became beneficial owners of more than 5% of our then outstanding common stock.

PRINCIPAL STOCKHOLDERS

The following table sets forth information with respect to the beneficial ownership of our common stock as of March 22, 2005, the date of the table, 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 executive officers named in the summary compensation table contained in the "Management" section of this prospectus; and
- 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 contained in the private placement description titled "January 2005 Private Placement of Common Stock and Warrants" following the selling security holder table included in this prospectus under the heading "Selling Security Holders," 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 37,384,708 shares of common stock outstanding as of the date of the table.

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, Runyon, Finnegan and Baskin are directors of Emrise. Messrs. Oliva, Jefferies and Foote are executive officers of Emrise.

NAME OF BENEFICIAL OWNER	TITLE OF CLASS	AMOUNT AND NATURE OF BENEFICIAL OWNERSHI
Carmine T. Oliva..................................	Common	1,320,305(1)

Robert B. Runyon.................................	Common	346,146(2)
Laurence P. Finnegan, Jr..........................	Common	210,171(2)
Otis W. Baskin....................................	Common	25,000(3)
Graham T. Jefferies...............................	Common	167,276(4)
Randolph D. Foote.................................	Common	102,500(5)
The Pinnacle Fund, L.P............................	Common	3,125,000(6)
JLF Asset Management, LLC and Jeffrey L. Feinberg..	Common	3,779,136(7)
JLF Offshore Fund, Ltd............................	Common	2,120,409(8)
Marathon Capital Management, LLC	Common	2,057,100(9)
All executive officers and directors as a group (6 persons)...................................	Common	2,171,398(10)

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* Less than 1.00%

(1) Includes 81,889 shares held individually by Mr. Oliva's spouse, and 166,000 shares underlying options.

(2) Includes 166,000 shares underlying options.

(3) Represents shares underlying options.

(4) Includes 164,000 shares underlying options. .

(5) Includes 97,500 shares underlying options.

(6) Includes 625,000 shares underlying a warrant. Power to vote or dispose of the shares is held by Barry M. Kitt, as sole member of Pinnacle Fund Management, LLC, which entity is the general partner of Pinnacle Advisers, L.P., which entity is the general partner of The Pinnacle Fund, L.P. The address for Mr. Kitt is c/o The Pinnacle Fund, L.P., 4965 Preston Park, Blvd., Suite 240, Plano, TX 75093.

(7) Includes an aggregate of 3,368,700 outstanding shares held by JLF Offshore Fund, Ltd., JLF Partners I, L.P., Guggenheim Portfolio Company XXVIII, and JLF Partners II, L.P., and an aggregate of 410,436 shares underlying warrants held by those four entities. Due to a contractual 9.999% beneficial ownership limitation that cannot be waived, excludes 289,564 shares underlying warrants held by those four entities. If the beneficial ownership limitation were disregarded, JLF Asset Management, LLC and Mr. Feinberg would have beneficially owned 10.68% of the shares of our common stock outstanding as of the date of the table. Power to vote or dispose of the shares is held by Jeffrey L. Feinberg, as managing member of JLF Asset Management, LLC, which entity is investment manager of the four entities named in the preceding sentence. The address for Mr. Feinberg is c/o JLF Asset Management, LLC, 2775 Via de la Valle, Suite 204, Del Mar, CA 92014.

(8) Includes 364,750 shares underlying a warrant. Power to vote or dispose of the shares is held by Jeffrey L. Feinberg, as managing member of JLF Asset Management, LLC, which entity is investment manager of JLF Offshore Fund, Ltd. See footnote (7) above for information regarding JLF Asset Management, LLC.

(9) Based on information included by Marathon Capital Management, LLC ("Marathon") in a Schedule 13G for January 13, 2005. Marathon reported that it holds sole voting power over 125,000 shares and sole disposal power over 2,057,100 shares. The Schedule 13G was executed by James G. Kennedy, as President of Marathon. The address for Marathon is P.O. Box 771, Hunt Valley, MD 21030.

(10) Includes 784,500 shares underlying options and 81,889 outstanding shares held individually by Mr. Oliva's wife.

SELLING SECURITY HOLDERS

SELLING SECURITY HOLDER TABLE

This prospectus covers the offer and sale by the selling security holders of up to an aggregate of 18,388,777 shares of common stock, including an aggregate of 13,782,092 issued and outstanding shares of our common stock and an aggregate of 4,606,685 shares of our common stock underlying warrants. The following table sets forth, to our knowledge, certain information about the selling security holders as of March 22, 2005, the date of the table, based on information furnished to us by the selling security holders. Except as indicated in the private placement descriptions or footnotes following the table, each selling security holder has indicated to us that it is acting individually, not as a member of a group, and none of the selling security holders or their affiliates has held any position or office or had any other material relationship with us in the past three years.

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 contained in the private placement descriptions and footnotes following the table, 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 37,384,708 shares of common stock outstanding as of the date of the table. Shares shown as beneficially owned after the offering assume that all shares being offered are sold.

The shares of common stock being offered under this prospectus may be offered for sale from time to time during the period the registration statement of which this prospectus is a part remains effective, by or for the accounts of the selling security holders described below. Roth Capital Partners, LLC ("Roth Capital") is an NASD-registered broker-dealer that received warrants as compensation for services rendered as placement agent in the January 2005 private placement described below. Roth Capital has represented to us that it is not acting as an underwriter in this offering, it received the warrants whose underlying shares are offered under this prospectus in the ordinary course of business, and at the time of such receipt, it had no agreements or understandings, directly or indirectly, with any person to distribute the warrants or underlying shares.

NAME OF BENEFICIAL OWNER	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO OFFERING		SHARES OF COMMON STOCK BEING OFFERED	BE A
	NUMBER	PERCENTAGE		NU
JLF Offshore Fund, Ltd...........	2,120,409 (1)	5.62%	1,823,750 (1)	2
JLF Partners I, LP...............	1,360,112 (2)	3.62%	1,172,500 (2)	1

Guggenheim Portfolio Company				
XXVIII.........................	483,041 (3)	1.29%	413,750 (3)	
JLF Partners II, LP..............	105,138 (4)	*	90,000 (4)	
The Pinnacle Fund, L.P...........	3,125,000 (5)	8.22%	3,125,000 (5)	
Bonanza Master Fund Ltd..........	1,750,000 (6)	4.64%	1,750,000 (6)	
Roaring Fork Capital SBIC, L.P....	1,706,250 (7)	4.52%	1,706,250 (7)	
Lagunitas Partners LP............	1,125,000 (8)	2.99%	1,125,000 (8)	
Gruber & McBaine International....	250,000 (9)	*	250,000 (9)	
Jon D. Gruber & Linda W. Gruber			0	
JTWROS.........................	1,581,250 (10)(30)	4.19%	206,250 (1)	
J. Patterson McBaine.............	1,481,250 (11)(30)	3.93%	106,250 (11)	
MicroCapital Fund LP.............	1,080,000 (12)	2.87%	1,080,000 (12)	
MicroCapital Fund Ltd............	607,500 (13)	1.62%	607,500 (13)	
Omicron Master Trust.............	1,085,625 (14)	2.89%	1,085,625 (14)	
Stratford Partners, L.P..........	431,250 (15)	1.15%	431,250 (15)	
Select Contrarian Value Partners,			6	
L.P............................	829,107 (16)	2.21%	375,000 (1)	4
Precept Capital Master Fund, G.P..	281,250 (17)	*	281,250 (17)	
Roth Capital Partners, LLC........	650,310 (18)	1.71%	650,310 (18)	
Noel C. McDermott, Trustee of the			9	
Noel C. McDermott Revocable				
Living Trust dated December 18,				
1995...........................	764,211 (19)	2.04%	764,211 (1)	
Warren P. Yost and Gail A. Yost,			0	
Co-Trustees Under Declaration				
of Trust dated March 9, 1988....	599,381 (20)	1.60%	599,381 (2)	
Hayden Communications, Inc........	75,000 (21)	*	125,000 (22)	
Coffin Partners LLC..............	35,000 (23)	*	35,000 (23)	
George Farndell..................	314,748 (24)	*	150,000 (24)	1
Steven Jacobus...................	50,000 (25)	*	50,000 (25)	
Jacques Moisset..................	120,000 (26)	*	120,000 (26)	
Jason Oliva......................	401,708 (27)	*	200,500 (27)	2
Joseph Mirabella.................	50,000 (28)	*	50,000 (28)	
Placido Albanese.................	15,000 (29)	*	15,000 (29)	

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* Less than 1.00%

(1) Includes 364,750 shares underlying a warrant. Power to vote or dispose of the shares is held by Jeffrey L. Feinberg, as managing member of JLF Asset Management, LLC. JLF Asset Management, LLC is investment manager of JLF Offshore Fund, Ltd. and of JLF Partners I, LP, Guggenheim Portfolio Company XXVIII and JLF Partners II, LP, three other selling security holders. The address for Mr. Feinberg is c/o JLF Asset Management, LLC, 2775 Via de la Valle, Suite 204, Del Mar, CA 92014.

(2) Includes 234,500 shares underlying a warrant. Power to vote or dispose of the shares is held by Jeffrey L. Feinberg, as managing member of JLF Asset Management, LLC. See footnote (1) above for information regarding JLF Asset Management, LLC.

(3) Includes 82,750 shares underlying a warrant. Power to vote or dispose of the shares is held by Jeffrey L Feinberg, as managing member of JLF Asset Management, LLC. See footnote (1) above for information regarding JLF Asset Management, LLC.

(4) Includes 18,000 shares underlying a warrant. Power to vote or dispose of the shares is held by Jeffrey L. Feinberg, as managing member of JLF Asset Management, LLC. See footnote (1) above for information regarding JLF Asset Management, LLC.

(5) Includes 625,000 shares underlying a warrant. Power to vote or dispose of the shares is held by Barry M. Kitt, as sole member of Pinnacle Fund Management, LLC, which entity is the general partner of Pinnacle Advisers, L.P., which entity is the general partner of The Pinnacle Fund, L.P. The address for Mr. Kitt is c/o The Pinnacle Fund, L.P., 4965 Preston Park, Blvd., Suite 240, Plano, TX 75093.

(6) Includes 350,000 shares underlying a warrant. Power to vote or dispose of the shares is held by Bernay Box, as president of Bernay Box & Co., which entity is the general partner of Bonanza Master Fund Ltd.

(7) Includes 341,250 shares underlying a warrant. Sole power to vote or dispose of the shares is held by Eugene McColley as manager of Roaring Fork Management, LLC, which entity is the general partner of Roaring Fork Capital SBIC, L.P.

(8) Includes 225,000 shares underlying a warrant. Power to vote or dispose of the shares is held by Jon D. Gruber and J. Patterson McBaine, as managers of Gruber & McBaine Capital Management, which entity is the general partner of Lagunitas Partners LP.

(9) Includes 50,000 shares underlying a warrant. Power to vote or dispose of the shares is held by Jon D. Gruber and J. Patterson McBaine, as managers of Gruber & McBaine Capital Management, which entity is the investment advisor to Gruber & McBaine International.

(10) Includes 316,250 shares underlying a warrant held by Jon D. Gruber & Linda W. Gruber JTWROS.

(11) Includes 296,250 shares underlying a warrant.

(12) Includes 216,000 shares underlying a warrant. MicroCapital LLC is the general partner and investment advisor to MicroCapital Fund LP and MicroCapital Fund Ltd. Ian P. Ellis is the principal owner of MicroCapital LLC and has sole responsibility for the selection, acquisition and disposition of the portfolio securities by MicroCapital LLC on behalf of its funds.

(13) Includes 121,500 shares underlying a warrant. MicroCapital LLC is the general partner and investment advisor to MicroCapital Fund LP and MicroCapital Fund Ltd. Ian P. Ellis is the principal owner of MicroCapital LLC and has sole responsibility for the selection, acquisition and disposition of the portfolio securities by MicroCapital LLC on behalf of its funds.

(14) Includes 217,125 shares underlying a warrant. Omicron Capital, L.P., a Delaware limited partnership (Omicron Capital), serves as investment manager to Omicron Master Trust, a trust formed under the laws of Bermuda (Omicron). Bruce Bernstein is the managing member of Omicron Capital. Omicron Capital, Inc., a Delaware corporation (OCI), serves as general partner of Omicron Capital, and Winchester Global Trust Company Limited (Winchester) serves as the trustee of Omicron. By reason of such relationships, Omicron Capital and OCI may be deemed to share dispositive power over the shares of our common stock owned by Omicron, and Winchester may be deemed to share voting and dispositive power over the shares of our common stock owned by Omicron. Omicron Capital, OCI and

Winchester disclaim beneficial ownership of such shares of our common stock. No other person has sole or shared voting or dispositive power with respect to the shares of our common stock being offered by Omicron, as those terms are used for purposes of Regulation 13D-G under the Exchange Act. Omicron and Winchester are not "affiliates" of one another, as that term is used for purposes of the Exchange Act, or of any other person named in this prospectus as a selling security holder. No person or "group" (as that term is used in Section 13(d) of the Exchange Act or Regulation 13D-G) controls Omicron and Winchester.

(15) Includes 86,250 shares underlying a warrant. Power to vote or dispose of the shares is shared by Mark Fain and Chad Comiteau, as managing directors of Stratford Advisors LLC, which entity is the general partner of Stratford Partners, L.P.

(16) Includes 75,000 shares underlying a warrant. Power to vote or dispose of the shares is held by David W. Berry as principal of Kaizen Capital, LLC, which entity is the general partner of Select Contrarian Value Partners, L.P.

(17) Includes 56,250 shares underlying a warrant. Power to vote or dispose of the shares is held by D. Blair Baker, as president of Precept Management, LLC, which entity is the general partner of Precept Capital Management, L.P., which entity is the agent of Precept Capital Master Fund, G.P.

(18) Represents 650,310 shares underlying a warrant. Power to vote or dispose of the shares is held by Byron Roth, as Chief Executive Officer, and Gordon J. Roth, as Chief Financial Officer, of Roth Capital.

(19) Includes 84,066 shares underlying a warrant. Sole power to vote or dispose of the shares is held by Mr. McDermott as trustee. Mr. McDermott was an officer and shareholder of Larus Corporation until its acquisition by Emrise in July 2004.

(20) Includes 65,934 shares underlying a warrant. Mr. Yost was an officer and shareholder of Larus Corporation until its acquisition by Emrise in July 2004.

(21) Represents 75,000 shares underlying warrants. Power to vote or dispose of the shares is held by Matthew Hayden as president of Hayden Communications, Inc. Hayden Communications, Inc. acts as an investor relations consultant to Emrise.

(22) Represents 125,000 shares underlying warrants.

(23) Represents 35,000 shares underlying warrants. Power to vote or dispose of the shares is held by William F. Coffin as Chief Executive Officer of Coffin Communications Group, an affiliate of Coffin Partners LLC. Coffin Communications Group is a former investor relations consultant to Emrise.

(24) Includes 150,000 shares underlying a warrant and 103,181 shares held by Mr. Farndell's spouse. Mr. Farndell is a former human resources consultant to Emrise and is the brother-in-law of Carmine T. Oliva, who is an executive officer and director of Emrise.

(25) Includes 50,000 shares underlying a warrant. Mr. Jacobus is a former financial advisor to Emrise.

(26) Includes 120,000 shares underlying a warrant. Mr. Moisset is a former employee of and former consultant to Emrise.

(27) Includes 200,500 shares underlying warrants. Jason Oliva is a former financial advisor to Emrise and is the son of Carmine T. Oliva, who is an executive officer and director of Emrise.

(28) Mr. Mirabella is a former consultant to Emrise.

(29) Mr. Albanese is a former financial advisor to Emrise.

(30) Also includes aggregates of 1,100,000 outstanding shares and 275,000 shares underlying warrants held by Lagunitas Partners, LP and Gruber & McBaine International, two other selling security holders.

PRIVATE PLACEMENTS THROUGH WHICH THE SELLING SECURITY HOLDERS OBTAINED BENEFICIAL OWNERSHIP OF THE OFFERED SHARES

All of the shares of common stock being offered under this prospectus were issued, or are issuable upon exercise of warrants that were issued, in the below-described private placement transactions.

JANUARY 2005 PRIVATE PLACEMENT OF COMMON STOCK AND WARRANTS

On January 5, 2005, we issued to 17 accredited record holders in a private offering an aggregate of 12,503,500 shares of our 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.

Roth Capital, an NASD-registered broker-dealer, acted as placement agent in connection with the offering. We paid to Roth Capital 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 our common stock at an exercise price of $1.72 per share in connection with the offering.

We agreed to register for resale the shares of common stock issued to investors and the shares of common stock issuable upon exercise of the investor warrants and placement warrants. The registration obligations require, among other things, that the registration statement of which this prospectus is a part be declared effective no later than the 150th day following the closing date. If we are unable to meet this obligation or are unable to maintain the effectiveness of the registration in accordance with the requirements of the registration rights agreement that we entered into with the investors, then we will be required to pay to each investor liquidated damages equal to 1% of the amount paid by the investor for the common shares still owned by the investor on the date of the default and 2% of the amount paid by the investor for the common shares still owned by the investor on each monthly anniversary of the date of the default that occurs prior to the cure of the default. The maximum aggregate liquidated damages payable to any investor will be equal to 10% of the aggregate amount paid by the investor for the shares of common stock. Accordingly, the maximum aggregate penalty that we would be required to pay under this provision is 10% of the approximate $18,005,000 initial purchase price of the shares of common stock, which would be $1,801,000.

The investor warrants and the placement warrants contain customary

anti-dilution provisions for stock splits, stock dividends and the like and contain a net exercise cashless exercise feature that will permit the warrants to be exercised for a net number of shares using the spread between the warrant exercise price and the average of the closing sale prices for the five trading days immediately prior to the exercise of the warrant as payment for a reduced number of common shares. Use of the cashless exercise feature by the investors is limited to times when a valid resale prospectus is not then available for use by the investors.

The investor warrants and the placement warrants also contain a call provision. The call provision generally provides that if, at any time after the first anniversary of the issuance of the warrants, the volume weighted average trading price of our common stock for each of 30 consecutive trading days exceeds $3.46, a valid resale prospectus is available for the shares of common stock underlying the warrants or the shares are eligible for resale without volume restrictions pursuant to Rule 144(k) under the Securities Act, and we have complied with our obligations under the warrant and related agreements, then we may require the warrant holder to exercise the warrant in full (subject to the 9.999% limitation described below) on the 30th day following written notice to the warrant holder if the call eligibility criteria described above continue to be met until that date.

In addition, the investor warrants and the placement warrants contain provisions limiting the exercise or call of the warrants to the extent necessary to insure that following the exercise or call, 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. As a result of the beneficial ownership limitations, the numbers of shares shown in the table as beneficially owned by certain of the selling security holders may have been reduced as described in the footnotes to the table.

We have registered for resale under this prospectus the shares of common stock issued to investors in the offering and the shares of common stock underlying the investor warrants and the placement warrants. The securities purchase agreement, registration rights agreement and placement agent arrangements contain various indemnification provisions in connection with the offering and registration of the shares and warrants. There are no material relationships between us or our affiliates and any of the investors or placement agents, except that each of The Pinnacle Fund, L.P., JLF Offshore Fund, Ltd., JLF Asset Management, LLC (which entity is investment manager of four of the selling security holders, including JLF Offshore Fund, Ltd.) and Jeffrey L. Feinberg (the managing member of JLF Asset Management, LLC), became a beneficial owner of more than 5% of our outstanding common stock at the closing of the offering.

LARUS CORPORATION ACQUISITION

As described elsewhere in this prospectus, we acquired the outstanding capital stock of Larus Corporation in July 2004 from Noel C. McDermott, Trustee

of the Noel C. McDermott Revocable Living Trust dated December 18, 1995, and Warren P. Yost and Gail A. Yost, Co-Trustees Under Declaration of Trust dated March 9, 1988. 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 have since been repaid, $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 stock at $1.30 per share 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 warrants contain a net exercise cashless exercise feature that will permit the warrants to be exercised for a net number of shares using the spread between the warrant exercise price and the average of the last reported sale prices for a share of our common stock on the OTC Bulletin Board for the five trading days immediately prior to the exercise of the warrant as payment for a reduced number of common shares. We granted the sellers piggyback and demand registration rights for the shares we issued to them in the acquisition and for the shares that are issuable upon exercise of the warrants issued in the acquisition and have registered all of those shares for resale under this prospectus.

HAYDEN COMMUNICATIONS, INC. INVESTOR RELATIONS WARRANTS

In November 2004, we issued to Hayden Communications, Inc. warrants to purchase up to 100,000 shares of common stock as partial consideration for investor relations services. The warrants vest and become exercisable in three installments. The warrants vested on November 3, 2004 as to 25,000 underlying shares with an exercise price of $0.85 per share and on March 3, 2005 as to 25,000 underlying shares with an exercise price of $1.00 per share. The warrants

vest on June 3, 2005 as to the remaining 50,000 underlying shares with an exercise price of $1.15 per share. The warrants are exercisable for a period of three years commencing on their respective vesting dates.

On January 24, 2005, we issued to Hayden Communications, Inc. a fully-vested three-year warrant to purchase up to 25,000 shares of common stock as additional consideration for investor relations services. The exercise price of the warrant is $2.00 per share. All of the warrants issued to Hayden Communications, Inc. contain a net exercise cashless exercise feature that will permit the warrants to be exercised for a net number of shares using the spread between the warrant exercise price and the average of the last bid and asked prices reported on the last business day immediately prior to the exercise of the warrant as payment for a reduced number of common shares. We have agreed to register for resale and have included in this prospectus the 125,000 shares of common stock underlying the warrants issued to Hayden Communications, Inc.

OTHER PRIVATE PLACEMENT TRANSACTIONS

In April 2001, we issued to Coffin Partners LLC a five-year warrant to purchase up to 35,000 shares of common stock at a per share exercise price of $0.39 in consideration for investor relations services to be rendered by its affiliate, Coffin Communications Group. We have included these underlying shares for resale under this prospectus.

In October 2001, we issued to Placido Albanese a three-year warrant to purchase up to 15,000 shares of common stock at a per share exercise price of $0.25 in consideration for financial advisory services rendered. Mr. Albanese

exercised this warrant, and we have included the 15,000 outstanding shares of common stock for resale under this prospectus.

In October 2001, we issued to Joseph Mirabella a three-year warrant to purchase up to 50,000 shares of common stock at a per share exercise price of $0.31 in consideration for consulting services rendered. Mr. Mirabella exercised this warrant, and we have included the 50,000 outstanding shares of common stock for resale under this prospectus.

In September 2002, we issued to Jacques Moisset a three-year warrant to purchase up to 120,000 shares of common stock at a per share exercise price of $0.50 in consideration for post-retirement business services rendered. We have included these underlying shares for resale under this prospectus.

In April 2003, we issued to George Farndell a three-year warrant to purchase up to 150,000 shares of common stock at a per share exercise price of $0.75 in consideration for human resources consulting services rendered. We have included these underlying shares for resale under this prospectus.

In April 2003, we issued to Steven Jacobus a three-year warrant to purchase up to 50,000 shares of common stock at a per share exercise price of $0.75 in consideration for financial advisory services rendered. We have included these underlying shares for resale under this prospectus.

In April 2003, we issued to Jason Oliva three-year warrants to purchase up to 100,000 shares of common stock at a per share exercise price of $0.75 and up to 100,500 shares of common stock at a per share exercise price of $1.00 in consideration for financial advisory services rendered. We have included these underlying shares for resale under this prospectus.

PLAN OF DISTRIBUTION

The selling security holders and any of their donees, pledgees, assignees and other successors-in-interest may, from time to time, sell any or all of their shares of common stock being offered under this prospectus on any stock exchange, market or trading facility on which the shares are traded, or in private transactions. These sales, which may include block transactions, may be at fixed or negotiated prices. The selling security holders may use any one or more of the following methods when disposing of shares:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resales by the broker-dealer for its own account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;
- through the distribution of the shares by any selling security

holder to its partners, members or stockholders;

- broker-dealers may agree with the selling security holders to sell a specified number of shares at a stipulated price per share;

- one or more underwritten offerings on a firm commitment or best efforts basis;

- a combination of any of these methods of sale; or

- any other method permitted by applicable law; provided, however, that the selling security holders have agreed not to engage in short sales involving the shares offered under this prospectus.

The shares may also be sold under Rule 144 under the Securities Act, if available, rather than under this prospectus. The selling security holders have the sole and absolute discretion not to accept any purchase offer or make any sale of shares if they deem the purchase price to be unsatisfactory at any particular time.

The selling security holders may pledge their shares to their brokers under the margin provisions of customer agreements. If a selling security holder defaults on a margin loan, the broker may, from time to time, offer and sell the pledged shares.

Broker-dealers engaged by the selling security holders may arrange for other broker-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the selling security holders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated, which commissions as to a particular broker or dealer may be in excess of customary commissions to the extent permitted by applicable law.

If sales of shares offered under this prospectus are made to broker-dealers as principals, we would be required to file a post-effective amendment to the registration statement of which this prospectus is a part. In the post-effective amendment, we would be required to disclose the names of any participating broker-dealers and the compensation arrangements relating to such sales.

The selling security holders and any broker-dealers or agents that are involved in selling the shares offered under this prospectus may be deemed to be "underwriters" within the meaning of the Securities Act in connection with these sales. Commissions received by these broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. Any broker-dealers or agents that are deemed to be underwriters may not sell shares offered under this prospectus unless and until we set forth the names of the underwriters and the material details of their underwriting arrangements in a supplement to this prospectus or, if required, in a replacement prospectus included in a post-effective amendment to the registration statement of which this prospectus is a part.

The selling security holders may sell all or any part of the shares offered under this prospectus through an underwriter. To our knowledge, no selling security holder has entered into any agreement with a prospective underwriter, and we cannot assure you as to whether any such agreement will be

entered into. If a selling security holder informs us that it has entered into such an agreement or agreements, any material details will be set forth in a supplement to this prospectus or, if required, in a replacement prospectus included in a post-effective amendment to the registration statement of which this prospectus is a part.

The selling security holders and any other persons participating in the sale or distribution of the shares offered under this prospectus will be subject to applicable provisions of the Exchange Act, and the rules and regulations under that act, including Regulation M. These provisions may restrict activities of, and limit the timing of purchases and sales of any of the shares by, the selling security holders or any other person. Furthermore, under Regulation M, persons engaged in a distribution of securities are prohibited from simultaneously engaging in market making and other activities with respect to those securities for a specified period of time prior to the commencement of such distributions, subject to specified exceptions or exemptions. All of these limitations may affect the marketability of the shares.

This prospectus does not cover the sale or other transfer of any of the derivative securities whose underlying shares of common stock are being offered for sale pursuant to this prospectus. If a selling security holder transfers those derivative securities prior to conversion or exercise, then the transferee of those derivative securities may not sell the underlying shares of common stock under this prospectus unless we amend or supplement this prospectus to cover such sales.

In addition, if any of the shares of common stock offered for sale pursuant to this prospectus are transferred other than pursuant to a sale under this prospectus, then subsequent holders could not use this prospectus until a post-effective amendment or prospectus supplement is filed, naming such holders. We offer no assurance as to whether any of the selling security holders will sell all or any portion of the shares offered under this prospectus.

For the period a selling security holder holds a derivative security whose underlying shares of common stock are being offered for sale pursuant to this prospectus, the selling security holder has the opportunity to profit from a rise in the market price of our common stock without assuming the risk of ownership of the underlying shares of common stock. The terms on which we could obtain additional capital during the period in which those derivative securities remain outstanding may be adversely affected. The holders of derivative securities are most likely to voluntarily convert or exercise their derivative securities when the conversion or exercise price is less than the market price for our common stock. However, we offer no assurance as to whether any of those derivative securities will be converted or exercised.

We have agreed to pay all fees and expenses incident to the registration of the shares being offered under this prospectus. However, each selling security holder and purchaser is responsible for paying any discounts, concessions and similar selling expenses they incur.

We and certain of the selling security holders have agreed to indemnify one another against certain losses, claims, damages and liabilities arising in connection with this prospectus, including liabilities under the Securities Act.

DESCRIPTION OF CAPITAL STOCK

Our authorized capital stock consists of 50,000,000 shares of common

stock, $0.0033 par value per share, and 10,000,000 shares of preferred stock, $0.01 par value per share. As of March 22, 2005, there were 37,384,708 shares of common stock issued and outstanding and no shares of preferred stock issued and outstanding. The following description of our capital stock does not purport to be complete and should be reviewed in conjunction with our certificate of incorporation and our bylaws.

COMMON STOCK

All outstanding shares of common stock are, and the common stock to be issued upon exercise of warrants and resold by the selling security holders in this offering will be, fully paid and nonassessable. The following summarizes the rights of holders of our common stock:

- each holder of common stock is entitled to one vote per share on all matters to be voted upon generally by the stockholders;
- subject to preferences that may apply to shares of preferred stock outstanding, the holders of common stock are entitled to receive lawful dividends as may be declared by our board of directors, see "Dividend Policy";
- upon our liquidation, dissolution or winding up, the holders of shares of common stock are entitled to receive a pro rata portion of all our assets remaining for distribution after satisfaction of all our liabilities and the payment of any liquidation preference of any outstanding preferred stock;
- there are no redemption or sinking fund provisions applicable to our common stock; and
- there are no preemptive or conversion rights applicable to our common stock.

PREFERRED STOCK

Our board of directors is authorized to issue from time to time, without stockholder authorization, in one or more designated series, any or all of our authorized but unissued shares of preferred stock with any dividend, redemption, conversion and exchange provision as may be provided in that particular series.

The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. Issuance of a new series of preferred stock, while providing desirable flexibility in connection with possible acquisitions

and other corporate purposes, could have the effect of entrenching our board of directors and making it more difficult for a third-party to acquire, or discourage a third-party from acquiring, a majority of our outstanding voting stock. We have no present plans to issue any shares of or to designate any series of preferred stock.

WARRANTS

At March 22, 2005, we had outstanding warrants to purchase 4,691,685

shares of our common stock at exercise prices ranging from $0.39 to $2.00.

OPTIONS

At March 22, 2005, we had outstanding options to purchase 1,458,998 shares of our common stock at exercise prices ranging from $0.20 to $3.44.

REGISTRATION RIGHTS

The holders of various shares of our common stock and warrants are entitled to rights with respect to the registration of their shares under the Securities Act. These registration rights are described in "Selling Security Holders."

ANTI-TAKEOVER EFFECTS OF DELAWARE LAW AND OUR CERTIFICATE OF INCORPORATION AND BYLAWS

Certain provisions of Delaware law, our certificate of incorporation and our bylaws contain provisions that could have the effect of delaying, deferring and discouraging another party from acquiring control of us. These provisions, which are summarized below, are expected to discourage coercive takeover practices and inadequate takeover bids. These provisions are also designed to encourage persons seeking to acquire control of us to first negotiate with our board of directors. We believe that the benefits of increased protection of our potential ability to negotiate with an unfriendly or unsolicited acquiror outweigh the disadvantages of discouraging a proposal to acquire us because negotiation of these proposals could result in an improvement of their terms.

CLASSIFIED BOARD

We have classified our board of directors into three classes of staggered terms. Each class has a term of three years. At each annual meeting, only those directors in one class are the subject of nomination and election. A classified board of directors makes it more difficult for dissident stockholders to wage a proxy fight to elect a majority of the directors.

UNDESIGNATED PREFERRED STOCK

The ability to authorize undesignated preferred stock makes it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us. These and other provisions may have the effect of deferring hostile takeovers or delaying changes in control or management of Emrise.

REQUIREMENTS FOR ADVANCE NOTIFICATION OF STOCKHOLDER NOMINATIONS AND PROPOSALS

Our bylaws establish advance notice procedures with respect to stockholder proposals and the nomination of candidates for election as directors, other than nominations made by or at the direction of the board of directors or a committee of the board of directors. The bylaws do not give the

board of directors the power to approve or disapprove stockholder nominations of candidates or proposals regarding business to be conducted at a special or annual meeting of the stockholders. However, our bylaws may have the effect of

precluding the conduct of certain business at a meeting if the proper procedures are not followed. These provisions may also discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of our company.

DELAWARE ANTI-TAKEOVER STATUTE

We are subject to the provisions of Section 203 of the Delaware General Corporation Law regulating corporate takeovers. In general, Section 203 prohibits a publicly-held Delaware corporation from engaging, under certain circumstances, in a business combination with an interested stockholder for a period of three years following the date the person became an interested stockholder unless:

- Prior to the date of the transaction, the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder.

- Upon completion of the transaction that resulted in the stockholder becoming an interested stockholder, the stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding (1) shares owned by persons who are directors and also officers and (2) shares owned by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer.

- On or subsequent to the date of the transaction, the business combination is approved by the board and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66?% of the outstanding voting stock which is not owned by the interested stockholder.

Generally, a business combination includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. An interested stockholder is a person who, together with affiliates and associates, owns or, within three years prior to the determination of interested stockholder status, did own 15% or more of a corporation's outstanding voting securities. We expect the existence of its provision to have an anti-takeover effect with respect to transactions our board of directors does not approve in advance. We also anticipate that Section 203 may also discourage attempts that might result in a premium over the market price for the shares of common stock held by stockholders.

The provisions of Delaware law, our certificate of incorporation and our bylaws could have the effect of discouraging others from attempting hostile takeovers and, as a consequence, they may also inhibit temporary fluctuations in the market price of our common stock that often result from actual or rumored hostile takeover attempts. These provisions may also have the effect of preventing changes in our management. It is possible that these provisions could make it more difficult to accomplish transactions that stockholders may otherwise deem to be in their best interests.

TRANSFER AGENT AND REGISTRAR

The stock transfer agent and registrar for our common stock is Computershare Investor Services. Its telephone number is (303) 986-5400.

LEGAL MATTERS

The validity of the shares of common stock offered in this offering will be passed upon for us by Rutan & Tucker, LLP, Costa Mesa, California.

EXPERTS

Grant Thornton LLP, independent registered public accounting firm, has audited our consolidated balance sheets as of December 31, 2004 and 2003, and related consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows for the years ended December 31, 2004, 2003 and 2002, as set forth in their report. Grant Thornton LLP has also audited our Schedule II for the years ended December 31, 2004, 2003 and 2002. We have included our consolidated financial statements and Schedule II in the prospectus and elsewhere in the registration statement in reliance on Grant Thornton LLP's report, given on their authority as experts in accounting and auditing.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed a registration statement on Form S-1 with respect to the common stock offered in this prospectus with the Commission in accordance with the Securities Act, and the rules and regulations enacted under its authority. This prospectus, which constitutes a part of the registration statement, does not contain all of the information included in the registration statement and its exhibits and schedules. Statements contained in this prospectus regarding the contents of any document referred to in this prospectus are not necessarily complete, and in each instance, we refer you to the full text of the document which is filed as an exhibit to the registration statement. Each statement concerning a document which is filed as an exhibit should be read along with the entire document. For further information regarding us and the common stock offered in this prospectus, we refer you to this registration statement and its exhibits and schedules, which may be inspected without charge at the Commission's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room.

The Commission also maintains an Internet website that contains reports, proxy and information statements, and other information regarding issuers, such as us, that file electronically with the Commission. The Commission's website address is http://www.sec.gov.

EMRISE CORPORATION AND SUBSIDIARIES

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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, a Delaware corporation, as of December 31, 2004 and 2003, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. 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 as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II of Emrise Corporation for each of the three years in the period ended December 31, 2004. In our opinion, this schedule presents fairly, in all material respects, the information required to be set forth therein.

/S/ GRANT THORNTON LLP

Los Angeles, California
March 11, 2005, except for Note 17,
as to which the date is March 18, 2005

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EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2004 AND 2003
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	2004	
ASSETS (Notes 5 and 6)		
Current assets:		
Cash and cash equivalents	$ 1,057	$
Accounts receivable, net of allowance for doubtful accounts of $153 and $161, respectively	5,796	
Inventories (Note 2)	6,491	
Deferred tax assets (Note 9)	352	
Prepaid and other current assets	417	
Total current assets	14,113	
Property, plant and equipment, net (Note 3)	909	
Goodwill, net of accumulated amortization of $1,084 and $1,070 in 2004 and 2003, respectively (Notes 4 and 15)	5,881	
Intangible assets other than goodwill, net of accumulated amortization of $40	3,560	
Other assets	623	
	$ 25,086	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Borrowings under lines of credit (Note 5)	$ 878	$
Current portion of long-term debt (Note 6)	211	
Notes payable to stockholders, current portion (Note 16)	500	
Accounts payable	3,398	
Income taxes payable	572	
Accrued expenses (Note 7)	3,014	

Total current liabilities	8,573	
Long-term debt, less current portion (Note 6)	985	
Notes payable to stockholders, less current portion (Note 16)	2,250	
Deferred income taxes	1,400	
Other liabilities	969	
Total liabilities	$ 14,177	$
Commitments and contingencies (Notes 11 and 17)		
Stockholders' equity (Note 8):		
Preferred stock, authorized 10,000,000 shares;		
Convertible Series B Preferred Stock, $0.01 par value, issued and outstanding zero shares and 1,000 shares at December 31, 2004 and 2003, respectively (aggregate liquidation preference of $0 and $4 at December 31, 2004 and 2003, respectively)	--	
Common stock, $0.0033 par value. Authorized 50,000,000 shares; issued and outstanding 24,777,000 shares and 23,476,000 shares in 2004 and 2003, respectively	82	
Additional paid-in capital	26,746	
Accumulated deficit	(16,406)	
Accumulated other comprehensive income	487	
Total stockholders' equity	10,909	
	$ 25,086	$

See accompanying notes to financial statements.

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	2004	2003	2002
Net sales (Note 12)	$ 29,861	$ 25,519	$ 22,664
Cost of sales	16,146	14,835	14,147
Gross profit	13,715	10,684	8,517
Operating expenses:			
Selling, general and administrative	10,226	7,812	7,731
Engineering and product development	1,521	951	1,015
Income (loss) from operations	1,968	1,921	(229)
Other income (expense):			
Interest expense	(433)	(416)	(441)
Other income (expense), net	(6)	(58)	80
Income (loss) before income taxes	1,529	1,447	(590)
Income tax expense (benefit) (Note 9)	49	286	(20)

Net income (loss)	$ 1,480	$ 1,161	$ (570)
Basic earnings (loss) per share	$ 0.06	$ 0.05	$ (0.03)
Diluted earnings (loss) per share	$ 0.06	$ 0.05	$ (0.03)

See accompanying notes to financial statements.

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
(IN THOUSANDS)

	2004	2003	2002
Net income (loss)	$ 1,480	$ 1,161	$ (570)
Other comprehensive income:			
Foreign currency translation adjustment	379	705	446
Comprehensive Income (loss)	$ 1,859	$ 1,866	$ (124)

See accompanying notes to financial statements.

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
(IN THOUSANDS)

	Series B Convertible Preferred Stock		Common Stock		Additional Paid-in	Acc
	Shares	Amount	Shares	Amount	Capital	D
Balance at December 31, 2001	150	$ 938	20,671	$ 68	$24,358	$(
Preferred Series B conversions	(86)	(538)	864	3	535	
Accretion of redeemable preferred stock	--	--	--	--	--	

Warrants issued for services	--	--	--	--	6	
Common stock issued for services	--	--	--	--	1	
Foreign currency translation adjustment	--	--	--	--	--	
Net loss	--	--	--	--	--	
Balance at December 31, 2002	64	400	21,535	71	24,900	(
Preferred Series A conversions	--	--	1,263	4	283	
Preferred Series B conversions	(63)	(396)	635	2	395	
Foreign currency translation adjustment	--	--	--	--	--	
Accretion of redeemable preferred stock	--	--	--	--	--	
Warrants issued for services	--	--	--	--	19	
Exercise of warrants and options	--	--	43	--	16	
Net income	--	--	--	--	--	
Balance at December 31, 2003	1	4	23,476	77	25,613	(
Preferred Series B conversions	(1)	(3)	3	--	3	
Preferred Series B redemption	--	(1)	--	--	--	
Stock options exercised	--	--	19	--	5	
Foreign currency translation adjustment	--	--	--	--	--	
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	
Net income	--	--	--	--	--	
Balance at December 31, 2004	--	--	24,777	$ 82	$26,746	$(

See accompanying notes to financial statements.

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
(IN THOUSANDS)

	2004
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income (loss)	$ 1,480
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:	
Depreciation and amortization	287
Deferred taxes	(206)
Provision for doubtful accounts	--
Provision for inventory obsolescence	1,116
Gain on sale of property, plant and equipment	--
Stock and warrants issued for services	38
Changes in operating assets and liabilities net of businesses acquired:	
Accounts receivable	289
Inventories	(394)
Prepaid and other assets	23
Accounts payable	1,414
Accrued expenses and other liabilities	(163)

Cash provided by (used in) operating activities	3,884
CASH FLOWS FROM INVESTING ACTIVITIES:	
Net purchases of property, plant and equipment	(724)
Cash received from sale of property, plant and equipment	8
Cash collected on notes receivable	--
Cash paid for acquisition of Larus net of cash acquired	(1,492)
Cash used in investing activities	(2,208)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net repayments of current notes payable	(2,004)
Repayments of long-term debt	(250)
Proceeds from long-term debt	65
Cash from warrant/option exercise	25
Cash used in financing activities	(2,164)
Effect of exchange rate changes on cash	371
Net increase (decrease) in cash and cash equivalents	(117)
Cash and cash equivalents at beginning of year	1,174
Cash and cash equivalents at end of year	$ 1,057

See accompanying notes to financial statements.

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
(IN THOUSANDS)

	2004	2003
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	$ 367	$ 38
Income taxes	$ 428	$ 8
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of subordinated notes for Larus acquisition	$ 3,000	$ -
Equipment acquired under capitalized lease	$ --	$ -
Common stock issued upon conversion of redeemable preferred stock	$ 3	$ 28

Accretion of redeemable preferred stock	$ --	$
Common stock issued to acquire Larus	$ 1,000	$ -

See accompanying notes to financial statements.

EMRISE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND BUSINESS

Emrise Corporation (the "Company"), operates through three wholly-owned subsidiaries: XET Corporation ("XET"), CXR Larus Corporation ("CXR Larus"), and CXR-Anderson Jacobson, formerly CXR, S.A. ("CXR-AJ"). XET Corporation and its subsidiaries design, develop, manufacture and market electronic components 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 components 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 components 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 delivery 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 our electronic components 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. 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 the Company's 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. Engineering/design services were not significant in 2004, 2003 and 2002. 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 does 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 components, 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 the Company's 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 5.7%, 3.1% and 2.5% of net sales in 2004, 2003 and 2002, respectively.

Shipping and handling fees billed to customers totaled $18,000 for domestic operations for the year ended December 31, 2004. Such amounts were not significant for the years ended December 31, 2003 and 2002. 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, 2004, 2003 and 2002. Depending on the operating division, shipping and handling costs are included in cost of sales or selling, general and administrative expenses. Shipping costs included in selling, general and administrative expenses approximated $100,000 in each of the years ended December 31, 2004, 2003 and 2002.

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, 2004 and 2003, cash in foreign accounts was $1,035,000 and $535,000, respectively.

INVENTORIES

The Company's finished goods electronic components inventories generally are built to order. The Company's 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 the Company's customers can promptly be served. The Company's products consist of numerous electronic and other parts, which necessitates that we 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 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. Demand for the Company's products can fluctuate significantly. A significant increase in the demand for the Company's products could result in a short-term increase in the cost of inventory purchases, while a significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand.

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 components, 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 2004 and

2003 were as follows:

	Year Ended December 31,	
	2004	2003
Liability, beginning of year	$ 79,000	$ 32,000
Expense for new warranties issued	64,000	79,000
Expense related to accrual revision for prior year warranties	--	--
Warranty claims	(79,000)	(32,000)
Liability, end of year	$ 64,000	$ 79,000

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

The Company applies Accounting Principles Bulletin ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its employee stock-based compensation plans. Accordingly, no compensation cost is recognized for its employee stock option plans unless the exercise price of options granted is less than fair market value on the date of grant. The Company has adopted the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148 "Accounting for Stock-Based Compensation - Presentation and Disclosure."

The following table sets forth the net income (loss), net income (loss) available for common stockholders and earnings (loss) per share amounts for the periods presented as if the Company had elected the fair value method of accounting for stock options:

	2004	2003
Net income (loss):		

As reported	$ 1,480,000	$ 1,161,000
Add: Stock-based compensation expense included in reported net income, net of related tax effect	--	--
Deduct: Stock-based compensation expense determined under the fair value-based method	(127,000)	(45,000)
Pro forma	$ 1,353,000	$ 1,116,000
Basic earnings (loss) per share:		
As reported	$ 0.06	$ 0.05
Add: Stock-based compensation expense included in reported net income, net of related tax effect	--	--
Deduct: Stock-based compensation expense determined under the fair value-based method	--	--
Pro forma	$ 0.06	$ 0.05
Diluted earnings (loss) per share:		
As reported	$ 0.06	$ 0.05
Add: Stock-based compensation expense included in reported net income, net of related tax effect	--	--
Deduct: Stock-based compensation expensed determined under the fair value-based method	(0.01)	--
Pro forma	$ 0.05	$ 0.05

The above calculations include the effects of all grants in the periods presented. Because options often vest over several years and additional awards are made each year, the results shown above may not be representative of the effects on net income or loss in future periods. The calculations were based on a Black-Scholes pricing model with the following assumptions: no dividend yield; expected volatility of 92% to 107%; risk-free interest rate of 3%-4.25%; expected lives of 7 years.

EARNINGS (LOSS) PER SHARE

Earnings (loss) per share is calculated according to SFAS No. 128, "Earnings Per Share." Basic earnings (loss) per share includes no dilution and is computed by dividing net income (loss) available to common stockholders by the weighted average number of shares outstanding during the year. Diluted earnings (loss) 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,

2004 and 2003, 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 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 U.S. operations and are stated net of 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 various BAE Systems companies in the U.S. and Europe represented approximately 15%, 13% and 14% of the Company's total net revenues during 2004, 2003 and 2002, respectively.

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 U.S. dollars at the current rate of exchange on the balance sheet date. 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 average exchange rates and included in operations. Such amounts are not material to the accompanying consolidated financial statements.

RECLASSIFICATIONS

Certain reclassifications have been made to the prior years' financial statements to be consistent with the 2004 presentation.

(2) INVENTORIES

Inventories are summarized as follows as of December 31:

	2004	2003
Raw materials	$ 3,222,000	$ 3,230,000
Work-in-process	1,280,000	1,963,000
Finished goods	1,989,000	1,490,000
	$ 6,491,000	$ 6,683,000

Included in the amounts above are allowances for inventory obsolescence of $2,251,000 and $1,692,000 at December 31, 2004 and 2003, 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.

(3) PROPERTY, PLANT AND EQUIPMENT

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

	2004	2003
Land and buildings	$ 390,000	$ 365,000
Machinery, equipment and fixtures	3,999,000	3,591,000
Leasehold improvements	482,000	435,000
	4,871,000	4,391,000
Accumulated depreciation	(3,962,000)	(4,069,000)
	$ 909,000	$ 322,000

(4) GOODWILL AMORTIZATION AND IMPAIRMENT TESTING

The Company initially applied SFAS No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002. SFAS No. 142 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. In applying SFAS No. 142, the Company performed the transitional reassessment and impairment tests required as of January 1, 2002. At the time of adoption, the Company had $1,084,000 of accumulated amortization of goodwill. The Company performed its annual required tests of impairment as of December 31, 2004 for goodwill in the XCEL Corporation Ltd. and CXR Telcom division reporting units and as of June 30, 2004 for the goodwill within the

Larus division reporting unit. No events or changes in circumstances occurred between annual tests that would have required an interim goodwill impairment test.

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(5) LINES OF CREDIT

A summary of notes payable is as follows as of December 31:

	2004	2003
Line of credit with a U.S. commercial lender	$ 118,000	$1,077,000
Lines of credit with foreign banks	760,000	1,805,000
	$ 878,000	$2,882,000

The Company had a credit facility with Wells Fargo Business Credit, Inc. through June 2004. The facility provided for a revolving loan of up to $3,000,000 secured by the Company's inventory and accounts receivable and a term loan in the amount of $687,000 secured by the Company's machinery and equipment. On December 31, 2003, the interest rate was the prime rate (then 4.0%) plus 1% subject to a minimum interest charge of $13,500 per month. Due to the minimum interest charge, the effective interest rate the Company paid for this credit facility during 2003 was 20.3%. The balance outstanding at December 31, 2003 was $1,077,000 on the revolving loan and $114,000 on the term loan, and $238,000 of additional borrowings were available under the revolving loan. The credit facility contained restrictive financial covenants that were set by mutual agreement each year.

On June 1, 2004, XET and CXR Larus, together with the Company acting as guarantor, obtained a credit facility from Wells Fargo Bank, N.A. for the Company's domestic operations. This facility is effective through July 1, 2005 and replaced the previous credit facility with Wells Fargo Business Credit, Inc. No prepayment penalty was due because the prior loan contract excluded from prepayment penalties loans replaced with new credit facilities from Wells Fargo Bank, N.A. Also, the new credit facility has no minimum interest but is subject to an unused commitment fee equal to 0.25% per annum, payable quarterly based on the average daily unused amount of the line of credit described in the following paragraph.

The new credit facility provides a $3,000,000 revolving line of credit secured by accounts receivable, other rights to payment and general intangibles, inventories and equipment. Borrowings do not need to be supported by specific receivables or inventory balances unless aggregate borrowings under the line of credit and the term loan described in the following paragraph exceed $2,000,000 for 30 consecutive days (a "conversion event"). If a conversion event occurs, the line of credit will convert into a formula-based line of credit until the borrowings are equal to or less than $2,000,000 for 30 consecutive days. The formula generally provides that outstanding borrowings under the line of credit may not exceed an aggregate of 80% of eligible accounts receivable, plus 15% of

the value of eligible raw material inventory, plus 30% of the value of eligible finished goods inventory. The interest rate is variable and is adjusted monthly based on the prime rate plus 0.5%. The prime rate at December 31, 2004 was 5.0%.

The previous credit facility bore interest at the prime rate plus 1.0% and was subject to a $13,500 minimum monthly interest fee plus an unused commitment fee equal to 0.25% per annum. The average amount outstanding on the revolving portions of the previous and new credit facilities during 2004 was $1,035,000. The prime rate averaged approximately 4.25% in 2004. Therefore, the average annual interest cost on the new revolving line of credit was approximately $49,162 while the average annual interest cost on the prior revolving line of credit was approximately $162,000 due to the minimum interest rate charge of $13,500 per month.

At December 31, 2004, the Company had a balance owing under the revolving credit line of $118,000, and had $1,882,000 of availability on the non-formula based portion of the credit line. The credit facility is subject to various financial covenants. Minimum debt service coverage ratio of each of XET and CXR Larus must be not less than 1.50:1.00 on a trailing four-quarter basis. "Debt service coverage ratio" equals net income plus depreciation plus amortization, minus non-financed capital expenditures, divided by current portion of long-term debt measured quarterly. Current ratio of each of XET and CXR Larus must be not less than 1.50:1.00, determined as of each fiscal quarter end. "Current ratio" is equal to total current assets divided by total current liabilities. Net income after taxes of each of XET and CXR Larus must be not less than $1.00 on an annual basis, determined as of the end of each quarter. Net profit after taxes of each of XET and CXR Larus must be not less than $1.00 in each fiscal quarter immediately following a fiscal quarter in which that entity incurred a net loss after taxes. Total liabilities divided by tangible net worth of the Company's domestic operations on a consolidated basis must not at any time be greater than 2.00:1.00, determined as of each fiscal quarter end. Tangible net worth of the Company and all of its subsidiaries on a consolidated basis must not at any time be less than $5,200,000, measured quarterly. "Total liabilities" equals current liabilities plus non-current liabilities, minus subordinated debt. "Tangible net worth" equals stockholders' equity plus subordinated debt, minus intangible assets.

At December 31, 2004, the Company was in compliance with the covenants other than the debt-to-tangible net worth covenant for its domestic operations. The Company obtained a waiver of non-compliance as of December 31, 2004. The Company is currently engaged in discussions with Wells Fargo Bank, N.A. to amend the existing financial covenants effective as of the next measurement date of April 30, 2005. If the Company is unable to comply with the existing or revised covenants and is unable to obtain a waiver or amendment on reasonable terms, the amount outstanding on the line of credit would become due and payable and a default interest rate of prime plus 4.5% would apply. The facility expires in July 2005. The Company currently intends to seek renewal of the facility and believes that the bank will be amenable to renewing it. However, the Company believes it has sufficient funds available to repay the facility if it is unable to obtain a renewal of the facility.

XPS, one of the Company's United Kingdom subsidiaries, has a credit facility with Venture Finance PLC, a subsidiary of the global Dutch ABN AMRO Holdings, N.V., that expires on November 12, 2005. Using the exchange rate in effect at December 31, 2004 for the conversion of British pounds sterling into United States dollars, the new facility is for a maximum of $2,865,000 and includes a $669,000 unsecured cash flow loan, a $153,000 term loan secured by XPS' fixed assets and the remainder of the loan is secured by XPS' accounts receivable and inventory. The interest rate is the base rate of Venture Finance PLC (4.75% at December 31, 2004) plus 2%, and is subject to a minimum rate of 4% per annum. There are no financial performance covenants applicable to this credit facility. At December 31, 2004 and 2003, the Company had balances owing under the United Kingdom revolving credit facility of $188,000 and $1,227,000, respectively.

On April 8, 2003, CXR-AJ obtained a credit facility from IFN Finance, a subsidiary of ABN AMRO Holdings N.V. The credit line is for a maximum of $1,488,000, based on the exchange rate in effect at December 31, 2004 for the conversion of euros into United States dollars. The IFN Finance facility replaced several smaller credit lines. The IFN Finance facility is secured by CXR-AJ's accounts receivable and carries an annual interest rate of 1.6 percentage points above the French "T4M" rate. The French T4M rate was 2.04% as of December 31, 2004. Funds that become available under the new IFN Finance credit line as new accounts receivables develop have been used to retire the prior existing CXR-AJ credit facilities. At December 31, 2004 and 2003, the balances outstanding under the French credit line were $572,000 and $578,000, respectively. There are no financial performance covenants applicable to this credit facility.

(6) LONG-TERM DEBT

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

	2004	2003
Term notes payable to commercial lender (a)	$ 184,000	$ 114,0
Term notes payable to foreign banks (b)	833,000	871,0
Capitalized lease obligations (c)	179,000	150,0
	1,196,000	1,135,0
Current portion	(211,000)	(316,0
	$ 985,000	$ 819,0

(a) The Company's domestic credit facility with Wells Fargo Bank, N.A. provides 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%. The term loan portion of the facility had a balance of $126,000 at December 31, 2004. Wells Fargo Bank, N.A. has also provided $300,000 of credit for the purchase of new capital equipment when needed, of which a balance of $58,000 was outstanding at December 31, 2004. The capital equipment loans are amortized over five years and bear interest at the bank's 30-day LIBOR rate plus 4%. As of December 31, 2003, the term notes totaling $114,000 were with the bank's financing subsidiary at the prime rate plus 1%, subject to a minimum interest charge of $13,500 included with the revolving loan.

(b) The Company has agreements with several foreign banks that include term borrowings that mature at various dates through 2007. Interest rates on the borrowings bear interest at rates ranging from 3.25% to 6.75% and are payable in monthly installments. The balances by country of origination at December 31, 2004 were: United Kingdom - $715,000; France - $62,000; and Japan - $56,000. At December 31, 2003, the balances by country of origination were: United Kingdom - $719,000; France - $79,000; and Japan - $73,000.

The United Kingdom term loan requires payments of $13,440 per quarter, is due and payable in total in 2006, carries an interest rate equal to the lender's base rate (4.75% at December 31, 2004 plus 2% (subject to a minimum rate of 4% per annum), is secured by $316,000 of fixed assets of XCEL Power Systems, Ltd. and is not subject to financial performance covenants.

The term loans in France had aggregate balances of $62,000 and $79,000 at December 31, 2004 and 2003, respectively, and are composed of several small loans payable over 36 to 60 months that are secured by the assets of the local subsidiary, bear annual interest rates ranging from 5.2% to 7.0% and are not subject to financial performance covenants.

The term loan in Japan is a five-year amortizable loan that commenced in November 2002 and had balances of $56,000 and $73,000 as of December 31, 2004 and 2003, 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 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.

Principal maturities related to long-term debt as of December 31, 2004 are as follows:

Year Ending December 31,	Amount
2005	$ 211,000
2006	828,000
2007	97,000
2008	25,000
2009	18,000
2010 and thereafter	17,000
Total	$ 1,196,000

CXR-AJ has term loans with Banc National de Paris and Sogelease with aggregate balances that totaled $62,000 and $128,000 as of December 31, 2004 and 2003, respectively.

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(7) ACCRUED EXPENSES

Accrued expenses as of December 31 consisted of the following (in thousands):

	2004	2003
Accrued salaries	$ 805	$ 593
Accrued payroll taxes and benefits	491	388
Advance payments from customers	77	656
Other accrued expenses	1,641	1,224
Total accrued expenses	$ 3,014	$ 2,861

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

(8) STOCKHOLDERS' EQUITY

STOCK OPTIONS AND WARRANTS

The Company has four stock option plans:

- o 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 MicroTel International Inc. 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 XET 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 ("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.

The Company accounts for stock-based compensation under the "intrinsic value" method. Under this method, no compensation expense is recorded for these plans and arrangements for current employees whose grants provide for exercise prices at or above the market price on the date of grant. Compensation or other expense is recorded based on intrinsic value (excess of market price over exercise price on date of grant) for employees, and fair value of the option

awards for others.

The following table shows activity in the outstanding options for the years ended December 31, 2004, 2003 and 2002:

	2004		2003		
	2004 Shares	Weighted Average Exercise Price	2003 Shares	Weighted Average Exercise Price	2002 Share
Outstanding at beginning of year	1,729,000	$0.96	1,432,000	$1.11	1,718,
Granted	424,000	$0.96	344,000	$0.35	50,
Exercised	(19,000)	$0.33	(28,000)	$0.24	
Forfeited	(1,000)	$3.44	(19,000)	$2.21	(336,
Outstanding at end of year	2,133,000	$0.97	1,729,000	$0.96	1,432,

The following table summarizes information with respect to stock options at December 31, 2004:

	Options			Options
Range of Exercise Price	Number Outstanding December 31, 2004	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable December 31 2004
$0.20 to $1.00	1,441,000	7.11	$0.54	1,017,000
$1.01 to $2.00	676,000	0.42	1.83	676,000
$3.01 to $4.00	16,000	1.40	3.22	16,000
	2,133,000	4.95	$0.97	1,709,000

The fair value of options granted during 2004 was $337,000, at a weighted average value of $0.97 per share. The fair value of options granted during 2003 was $42,000, at a weighted average value of $0.12 per share. The fair values of options granted during 2002 was $13,000 at a weighted average value of $0.26 respectively.

If the Company had instead elected the fair value method of accounting for stock-based compensation, compensation cost would be accrued at the estimated fair value of all stock option grants over the service period, regardless of later changes in stock prices and price volatility. The fair value at date of grant for options granted in 2004, 2003 and 2002 has been estimated based on a Black-Scholes pricing model with the following assumptions: no dividend yield; expected volatility of 92% to 107% in 2004, 92% in 2003 and 92% in 2002; risk-free interest rate of 3.0% to 4.25%; and average expected lives of seven years.

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The 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	Warra Per Share
Balance outstanding at December 31, 2001	1,972,000	$0.25 to $2.50
Warrants issued	120,000	$0.50
Warrants expired/forfeited	(1,688,000)	$0.25 to $1.73
Balance outstanding at December 31, 2002	404,000	$0.25 to $2.50
Warrants issued	401,000	$.75 to $1.00
Warrants expired/forfeited	(138,000)	$0.66
Warrants exercised	(14,000)	$0.66
Balance outstanding at December 31, 2003	653,000	$0.25 to $2.50
Warrants issued	250,000	$0.85 to $1.30
Warrants expired/forfeited	(32,000)	$2.50
Warrants exercised	(65,000)	$0.25 to $0.31
Balance outstanding at December 31, 2004	806,000	$0.31 to $1.30

During 2004, the Company issued warrants to purchase up to 250,000 shares of common stock at exercise prices ranging from of $0.85 to $1.30 per share in consideration for services rendered or to be rendered and in connection with the acquisition of Larus Corporation. The estimated value of the warrants issued for services rendered was $38,000 and was calculated using the Black-Scholes pricing model with the following assumptions: risk-free interest rate of 2.5% to 3.25%, expected life of 3 years, no dividend yield, and an expected volatility of 107%. The estimated value of the warrants issued in connection with the acquisition of Larus Corporation was $72,526 and was calculated using the Black-Scholes pricing model with the following assumptions: risk-free interest rate of 3.25%, expected life of three years, no dividend yield, and an expected volatility of 107.19%.

During 2003, the Company issued warrants to purchase up to 300,000 shares of common stock at the exercise price of $0.75 and 101,000 shares at the exercise price of $1.00. The Company issued the warrants for services rendered or to be rendered. The estimated value of the warrants was $19,000 and was calculated using the Black-Scholes pricing model with the following assumptions: risk-free interest rate of 1.6%, expected lives of 3 years, no dividend yield and an expected volatility of 84.8%.

During 2002, the Company issued warrants to purchase up to 120,000 shares of common stock at an exercise price of $0.50 per share. The Company issued the warrants to a former executive of the Company as compensation for

services rendered. The estimated value of the warrants was $6,000 and was calculated using the Black-Scholes pricing model with the following assumptions: no dividend yield; expected volatility of 92%; a risk-free interest rate of 3.75%; and a contractual life of 3 years. Also, during 2002 the Company issued 5,000 shares of common stock in consideration for services rendered. The stock was valued at $1,000 on the date of issuance and, accordingly, the Company recorded a $1,000 expense.

As of December 31, 2004, the Company was authorized to issue 50,000,000 shares of common stock. As of that date, the Company had 24,777,000 shares of common stock outstanding and 2,938,756 shares of common stock that could become issuable pursuant to the exercise of outstanding stock options and warrants.

As described in Note 17, the Company issued shares of common stock and warrants to purchase shares of common stock in a private offering on January 5, 2005.

DIVIDENDS

No dividends on the Company's common stock have been paid to date. The Company's line of credit with Wells Fargo Bank, N.A. prohibits the payment of cash dividends on the Company's common stock. The Company currently intends to retain future earnings to fund the development and growth of its business and, therefore, does not anticipate paying cash dividends on its common stock within the foreseeable future. Any future payment of dividends on the Company's common stock will be determined by the Company's board of directors and will depend on the Company's financial condition, results of operations, contractual obligations and other factors deemed relevant by the Company's board of directors.

(9) INCOME TAXES

The Company files a consolidated U.S. 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 (loss) from continuing operations before income taxes was taxed under the following jurisdictions:

	2004	2003
Domestic	$1,858,000	$ 961,000
Foreign	(329,000)	486,000
Total	$1,529,000	$ 1,447,000

Income tax expense (benefit) consists of the following:

	2004	2003
Current		
Federal	$ 34,000	$ 26,000
State	41,000	55,000
Foreign	180,000	351,000
Total Current	$ 255,000	$ 432,000
Deferred		
Federal	$ (193,000)	$ (132,000)
State	(11,000)	(14,000)
Foreign	(2,000)	--
Total Deferred	$ (206,000)	$ (146,000)
Total		
Federal	$ (159,000)	$ (106,000)
State	30,000	41,000
Foreign	178,000	351,000
Total	$ 49,000	$ 286,000

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Income tax expense (benefit) differs from the amount obtained by applying the statutory federal income tax rate of 34% to income (loss) from continuing operations before income taxes as follows:

	2004	2003
Tax (tax benefit) at U.S. federal statutory rate	$ 520,000	$ 492,000
State taxes, net of federal income tax benefit	41,000	43,000
Foreign income taxes	248,000	(63,000)
Change in valuation allowances	(179,000)	(182,000)
Permanent differences	(6,000)	12,000
Utilization of net operating losses	(575,000)	--
Other	--	(16,000)
	$ 49,000	$ 286,000

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 are as follows:

	2004	2003
Deferred tax assets:		
Fixed assets depreciation	$ 282,000	$ 269,
Allowance for doubtful accounts	12,000	10,
Inventory reserves and uniform capitalization	393,000	206,
Other accrued liabilities	179,000	112,
Deferred compensation	122,000	110,
Alternative minimum tax credit carryforwards	142,000	142,
Capital loss carryforwards	136,000	136,
Net operating loss carryforwards	11,740,000	12,315,
Total deferred tax assets	13,006,000	13,300,
Valuation allowance for deferred tax assets	(12,654,000)	(13,154,
Net deferred tax assets	$ 352,000	$ 146,
Deferred tax liability:		
Intangible assets other than goodwill	$ 1,400,000	$

As of December 31, 2004, the Company had recorded $352,000 of net deferred tax assets and $1,400,000 of deferred tax liabilities. The Company had federal and state net operating loss carryforwards of approximately $36,056,000 and $3,400,000 as of December 31, 2004 and 2003, respectively, that expire at various dates through 2022. As of December 31, 2004 and 2003, the Company recorded a valuation allowance on the net deferred tax asset. Management considers projected future taxable income and tax planning strategies in making this assessment. For the year ended December 31, 2004, management recorded a reduction in its valuation allowance of $179,000 based on the domestic income in 2004 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 these deductible differences. 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 XET with a wholly-owned, newly formed subsidiary of the Company, with XET 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 most of its federal net operating

loss and credit carryforwards. The amount of this annual limitation, as well as the impact of the application of other possible limitations under the consolidated return regulations, has not been definitively determined at this time. However, management believes approximately 80% of the federal and California net operating losses will not be available to offset future taxable income as a result of the limitations. Management believes sufficient uncertainty exists regarding the realizability of the deferred tax asset items and that a valuation allowance is required.

(10) EARNINGS (LOSS) PER SHARE

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

	2004	2003
NUMERATOR:		
Net income (loss)	$ 1,480,000	$ 1,161,000
Less: accretion of the excess of the redemption value over the carrying value of redeemable preferred stock	--	(4,000
Income (loss) attributable to common stockholders	$ 1,480,000	$ 1,157,000
DENOMINATOR:		
Weighted average number of common shares outstanding during the period - basic	24,063,000	22,567,000
Incremental shares from assumed conversions of warrants, options and preferred stock	776,000	1,244,000
Adjusted weighted average shares - diluted	24,839,000	23,811,000
Basic earnings (loss) per share	$ 0.06	$ 0.05
Diluted earnings (loss) per share	$ 0.06	$ 0.05

The following table shows the common stock equivalents that were outstanding as of December 31, 2004 and 2003 but were not included in the computation of diluted earnings (loss) 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, 2004	1,027,000	$1.00 to $3.44
As of December 31, 2003	693,000	$1.13 to $3.44
Anti-dilutive common stock warrants:		
As of December 31, 2004	326,000	$1.00 to $1.30
As of December 31, 2003	32,000	$2.50

The computation of diluted loss per share for 2002 excludes the effect of incremental common shares attributable to the exercise of outstanding common stock options and warrants because their effect was anti-dilutive due to losses incurred by the Company. See summary of outstanding stock options and warrants in Note 8.

EMRISE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002 (CONTINUED)

(11) 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 2004, 2003 and 2002 was approximately $1,070,000, $909,000 and $1,097,000, 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 16) are as follows:

Year Ending December 31,	Amount
2005	$ 1,040,000
2006	713,000
2007	725,000
2008	527,000
2009	420,000
2010 and thereafter	486,000
Total	$ 3,911,000

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 U.S. domestic employees. Participants may make voluntary pretax contributions to such plans up to the limit as permitted by law. Annual contributions to any plan by the Company is discretionary. The Company made contributions of $25,000, $20,000 and $22,000 to the 401(k) Plan for the years ended December 31, 2004, 2003 and 2002, respectively.

The Company's subsidiary in France has a defined benefit pension plan. The plan is an unfunded plan. As of the December 31, 2004 measurement date, the

status of the defined benefit pension plan was as follows:

Projected benefit obligation	$178,000
Fair value of plan assets	$ 12,000
Unfunded accumulated benefit	$166,000
Accumulated benefit obligation	$122,000
Employer contributions	$ 19,000
Participant contributions	$ --
Benefits paid	$ 19,000

Contributions to be paid to the plan during the year ended December 31, 2005 are estimated to be $20,000.

Weighted average assumptions used to determine pension benefit obligations at December 31, 2004 were as follows:

Discount rate	4.5%
Expected return on plan assets	--%
Rate of compensation increase	4.5%

The components of the net periodic pension costs for the year ended December 31, 2004 were as follows:

Service cost	$ 11,000
Interest cost	7,000
Expected return on plan assets	--
Amortization of transition asset, change in the prior service cost and actuarial loss	--
Net periodic benefit cost	$ 18,000

EMRISE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002 (CONTINUED)

The following table sets forth the changes in benefit obligation for the year ended December 31, 2004:

Change in benefit obligations:	
Benefit obligation at beginning of year	$ 96,000
Service cost	11,000
Interest cost	7,000
Benefits paid	(19,000)
Contributions	19,000
Effect of foreign currency translation	8,000
Benefit obligation at end of year	$122,000

EXECUTIVE MANAGEMENT

Effective January 1, 2001, the Company and Carmine T. Oliva, its Chief Executive Officer, entered into a new employment agreement that provides 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.

Effective July 2, 2001, the Company and Randolph D. Foote, its Senior Vice President and Chief Financial Officer, 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.

Effective July 2, 2001, the Company and Graham Jefferies, Managing Director of XCEL Corporation Ltd. and Executive Vice President and Chief Operating Officer of the Company's Telecommunications Group, 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.

(12) SEGMENT AND MAJOR CUSTOMER INFORMATION

The Company has two reportable segments: electronic components and communications equipment. The electronic components segment operates in the U.S., European and Asian markets and designs, manufactures and markets digital switches and power supplies. The communications equipment segment operates principally in the U.S. 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.

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, 2004:

Reporting Units Within Electronic Components Segment:

- XET Corporation - Rancho Cucamonga, California: Digitran Division- digital and rotary switches, and electronic subsystem assemblies for

defense and aerospace applications and keypads

- XET Corporation - Monrovia, California: XCEL Circuits Division - printed circuit boards mostly for intercompany sales

- XCEL Japan Ltd. - Tokyo, Japan: Reseller of Digitran switches and other third party electronic components

- XCEL Corporation Ltd. - Ashford, Kent, England: Power supplies and conversion for defense and aerospace applications; this reporting unit also includes XCEL Power Systems, Ltd., Belix Power Conversions Ltd., Belix Wound Components Ltd., and The Belix Company Ltd.

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 17, the Company acquired PEHL and Pascall in March 2005. These two entities are being included in XCEL Corporation Ltd. reporting unit of the electronic components segment.

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

	2004	2003	2002
SALES TO EXTERNAL CUSTOMERS:			
Electronic Components	$ 15,262,000	$ 16,168,000	$ 13,390,000
Communications Equipment	14,599,000	9,351,000	9,274,000
	$ 29,861,000	$ 25,519,000	$ 22,664,000
INTEREST EXPENSE:			
Electronic Components	$ 180,000	$ 247,000	$ 259,000
Communications Equipment	250,000	162,000	168,000
	$ 430,000	$ 409,000	$ 427,000
DEPRECIATION AND AMORTIZATION:			
Electronic Components	$ 91,000	$ 72,000	$ 93,000
Communications Equipment	126,000	65,000	177,000
	$ 217,000	$ 137,000	$ 270,000
SEGMENT PROFITS (LOSSES):			
Electronic Components	$ 2,612,000	$ 3,590,000	$ 2,452,000
Communications Equipment	1,733,000	74,000	(1,257,000)
	$ 4,345,000	$ 3,664,000	$ 1,195,000

SEGMENT ASSETS:			
Electronic Components	$ 8,435,000	$ 9,466,000	$ 9,445,000
Communications Equipment	16,313,000	6,969,000	6,773,000
	$ 24,748,000	$ 16,435,000	$ 16,218,000

EMRISE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002 (CONTINUED)

GOODWILL AND OTHER INTANGIBLE ASSETS BY SEGMENT

Gross cost	Goodwill -- Not Amortizable Since 2002	Trademarks and Tradenames -- Not Amortizable Since 2002	Technology Acquired -- 10-Year Life Amortizable
Electronic components	$ 1,297,000	$ --	$ --
Communications equipment	5,668,000	2,800,000	500,000
Total	$ 6,965,000	$ 2,800,000	$ 500,000
Accumulated amortization			
Electronic components	$ 212,000	$ --	$ --
Communications equipment	872,000	--	25,000
Total	$ 1,084,000	$ --	$ 25,000
Carrying value			
Electronic components	$ 1,085,000	$ --	$ --
Communications equipment	4,796,000	2,800,000	475,000
Total	$ 5,881,000	$ 2,800,000	$ 475,000

CHANGES IN GOODWILL BY SEGMENT

	Electronic Components	Communications Equipment	Total
Balance at January 1, 2002	$ 957,000	$ 1,432,000	$ 2,389,000
Goodwill acquired	--	--	--
Impairment	--	--	--
Foreign currency translation	(43,000)	--	(43,000)
Balance December 31, 2002	$ 914,000	$ 1,432,000	$ 2,346,000

Balance at January 1, 2003	$ 914,000	$ 1,432,000	$ 2,346,000
Goodwill acquired	--	--	--
Impairment	--	--	--
Foreign currency translation	101,000	--	101,000
Balance December 31, 2003	$ 1,015,000	$ 1,432,000	$ 2,447,000
Balance at January 1, 2004	$ 1,015,000	$ 1,432,000	$ 2,447,000
Goodwill acquired	--	3,363,000	3,363,000
Impairment	--	--	--
Foreign currency translation	70,000	1,000	71,000
Balance December 31, 2004	$ 1,085,000	$ 4,796,000	$ 5,881,000

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

	2004	2003	
Net sales			
Total sales for reportable segments	$ 29,861,000	$ 25,519,000	$ 2
Elimination of intersegment sales	--	--	
Total consolidated net sales	$ 29,861,000	$ 25,519,000	$ 2
Profit (loss) from continuing operations before income taxes			
Total profit (loss) for reportable segments	$ 4,345,000	$ 3,656,000	$
Unallocated amounts:			
General corporate expenses	(2,816,000)	(2,209,000)	(
Consolidated income (loss) from continuing operations before income taxes	$ 1,529,000	$ 1,447,000	$
Assets			
Total assets for reportable segments	$ 24,748,000	$ 16,437,000	$ 1
Other assets	338,000	732,000	
Total consolidated assets	$ 25,086,000	$ 17,169,000	$ 1
Interest expense			
Interest expense for reportable segments	$ 430,000	$ 409,000	$
Other interest expense	3,000	7,000	
Total interest expense	$ 433,000	$ 416,000	$
Depreciation and amortization			
Depreciation and amortization expense for reportable segments	$ 217,000	$ 185,000	$

Other depreciation and amortization expense	70,000	64,000	
Total depreciation and amortization	$ 287,000	$ 249,000	$

EMRISE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002 (CONTINUED)

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

	2004	2003	2002
Net sales:			
United States	$12,745,000	$ 7,971,000	$ 8,598,000
Japan	935,000	838,000	768,000
France	7,016,000	6,627,000	5,854,000
United Kingdom	9,165,000	10,083,000	7,444,000
	$29,861,000	$25,519,000	$22,664,000
Long-lived assets:			
United States	$ 440,000	$ 117,000	$ 399,000
Japan	11,000	16,000	15,000
France	142,000	107,000	177,000
United Kingdom	316,000	82,000	97,000
	$ 909,000	$ 322,000	$ 688,000

Sales and purchases between geographic areas have been accounted for on the basis of prices set between the geographic areas, generally at cost plus 5%. 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.

One customer in the electronic components segment accounted for 10% or more of net sales during 2004, 2003 and 2002.

(13) NEW ACCOUNTING PRONOUNCEMENTS

In December 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits," an amendment of SFAS No. 87, 88 and 106, and a revision of SFAS No. 132. The statement is effective for fiscal years and interim periods ending after December 15, 2003. This Statement revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required

by SFAS No. 87, 88 and 106. The new rules require additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans. The adoption of this statement did not have a material effect on the Company's financial condition or results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," which addresses the accounting for employee stock options. SFAS No. 123R eliminates the ability to account for shared-based compensation transactions using APB Opinion No. 25 and generally would require instead that such transactions be accounted for using a fair value-based method. SFAS No. 123R also requires that tax benefits associated with these share-based payments be classified as financing activities in the statement of cash flow rather than operating activities as currently permitted. SFAS No. 123R becomes effective for interim or annual periods beginning after June 15, 2005. Accordingly, we are required to apply SFAS No. 123R beginning in the quarter ending September 30, 2005. SFAS No. 123R offers alternative methods of adopting this final rule. The Company has not yet determined which alternative method it will use.

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 are effective for the Company's fiscal 2006. The Company is currently evaluating the provisions of SFAS No. 151 and does not expect that adoption will have a material effect on the Company's financial position, results of operations or cash flows.

(14) QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a summary of the quarterly operations for the years ended December 31, 2004 and 2003 (in thousands, except for per share data).

2004	Mar. 31	June 30	Sept. 30	Dec. 31
Net sales	$ 6,192	$ 6,432	$ 7,469	$ 9,768
Gross profit	$ 2,747	$ 2,899	$ 3,230	$ 4,839
Net income	$ 70	$ 369	$ 158	$ 883
Income available to common stockholder	$ 70	$ 369	$ 158	$ 883
Earnings per share:				
Basic	$ --	$ 0.02	$ 0.01	$ 0.04
Diluted	$ --	$ 0.02	$ 0.01	$ 0.03

2003	Mar. 31	June 30	Sept. 30	Dec. 31

Net sales	$ 5,668	$ 6,834	$ 6,420	$ 6,597
Gross profit	$ 2,141	$ 2,829	$ 2,715	$ 2,999
Net income	$ 44	$ 359	$ 504	$ 254
Income available to common stockholder	$ 42	$ 357	$ 504	$ 254
Earnings per share:				
Basic	$ --	$ 0.02	$ 0.02	$ 0.01
Diluted	$ --	$ 0.02	$ 0.02	$ 0.01

(15) 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, and approximately $580,000 of acquisition costs. The number of shares of our common stock issued as part of the purchase price was calculated based on the $0.824 per share average closing price of our common stock for the five trading days preceding the

transaction. The warrants to purchase 150,000 shares of common stock were valued at $72,000 using a Black-Scholes formula that included a volatility of 107.19%, an interest rate of 3.25%, a life of three years and no assumed dividend.

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. This lease represents an obligation that exceeds 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 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 determining

this premium, the Company considered the Company's potential ability to refine various Larus Corporation products and to use the Company's marketing resources and status as a qualified supplier to qualify and market those products for sale to large telecommunications companies. The Company believes that large telecommunications companies desired to have an additional choice of suppliers for those products and would be willing to purchase Larus Corporation's products following some refinements. The Company also believes that if Larus Corporation had remained independent, it was unlikely that it would have been able to qualify to sell its products to the large telecommunications companies due to its small size and lack of history selling to such companies. Therefore, Larus Corporation had a range of value separate from the net worth it had recorded on its books.

In conjunction with the Company's July 2004 acquisition of Larus Corporation, the Company has commissioned a valuation firm to determine what portion of the purchase price should be allocated to identifiable intangible assets. Although the valuation analysis is still in progress, the Company has estimated that the Larus tradename and trademark are valued at $2,800,000 and that the technology and customer relationships are valued at $800,000. Goodwill associated with the Larus Corporation acquisition totaled $3,363,000 and is not deductible for tax purposes. The Larus tradename 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 and, as a result, $40,000 of amortization expense was recorded and charged to administrative expense in 2004. The valuation of the identified intangible assets is expected to be completed in May 2005 and could result in changes to the value of these identified intangible assets and corresponding changes to the value of goodwill. However, the Company does not believe these changes will be material to its financial position or results of operations.

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	3,600
Goodwill	3,363
Total assets acquired	9,513
Current liabilities	(685)
Deferred income taxes	(1,400)
Unfavorable lease obligation and other liabilities	(888)
Total liabilities assumed	(2,973)
Net assets acquired	$ 6,540

The intangible assets other than goodwill consist of non-amortizable tradenames with a carrying value of $2,800,000, and technology and customer relationships with carrying values of $500,000 and $300,000, respectively, that are amortizable over ten years.

EMRISE CORPORATION AND SUBSIDIARIES

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YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002 (CONTINUED)

Amortization for the intangibles subject to amortization as of December 31, 2004 is anticipated to be approximately $80,000 per year for each of the next five years.

The following table summarizes, on an unaudited pro forma basis, the combined results of operations of the Company and Larus Corporation, as though the acquisition occurred as of January 1, 2003. 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,	
	2004	2003
Revenues	$ 32,486	$ 31,376
Net income	1,720	1,264
Earnings per share of common stock:		
Basic	$ 0.07	$ 0.06
Diluted	$ 0.07	$ 0.05

(16) 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 15). 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 rate 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. During December 2004, the 30-day LIBOR rate was 2.42%.

Future maturities of the notes payable to stockholders are as follows:

Year Ending December 31,	
2005	$ 500,000
2006	$ 500,000
2007	$ 500,000
2008	$ 500,000
2009	$ 500,000
Therafter	$ 250,000
	$2,750,000

Total interest paid on these notes in 2004 was $75,000.

The Company entered into an above-market real property lease with the sellers. This lease represents an obligation that exceeds 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 2004 totaled $171,000. Future minimum lease payments under the operating lease payable to the stockholders are included in Note 11.

There are no guarantees by officers or fees paid to officers or loans to or from officers. In 2004, the Company paid $10,000 to Jason Oliva, the son of Carmine T. Oliva, for specific financial analysis services. In 2003, the Company issued to Jason Oliva three-year warrants to purchase up to 100,000 shares of common stock at a per share exercise price of $0.75 and up to 100,500 shares of common stock at a per share exercise price of $1.00 in consideration for financial advisory services rendered.

(17) SUBSEQUENT EVENTS

JANUARY 2005 FINANCING

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 3,775,875 shares of the Company's common stock, have an estimated value of $4,400,000. Additional costs related to the financing include legal, accounting and consulting fees that continue to be incurred in connection with the resale registration described below. The Company used a portion of the proceeds from this financing to fund the acquisition of Pascall described below. The Company intends to use the remaining proceeds from this financing for additional acquisitions and for investments in new products and enhancements to existing products.

The Company agreed to register for resale the shares of common stock issued to investors and the shares of common stock issuable upon exercise of the investor warrants and placement warrants. The registration obligations require, among other things, that a registration statement be declared effective no later than the 150th day following the closing date. If the Company is unable to meet this obligation or unable to maintain the effectiveness of the registration in accordance with the requirements contained in the registration rights agreement the Company entered into with the investors, then the Company will be required

to pay to each investor liquidated damages equal to 1% of the amount paid by the investor for the common shares still owned by the investor on the date of the default and 2% of the amount paid by the investor for the common shares still owned by the investor on each monthly anniversary of the date of the default that occurs prior to the cure of the default. The maximum aggregate liquidated damages payable to any investor will be equal to 10% of the aggregate amount paid by the investor for the shares of the Company's common stock. Accordingly, the maximum aggregate penalty that the Company would be required to pay under this provision is 10% of the $18,005,000 initial purchase price of the common stock, which would be approximately $1,801,000. Although the Company anticipates that it will be able to meet its registration obligations, it also anticipates that it will have sufficient cash available to pay these penalties if required.

PASCALL ACQUISITION

On March 1, 2005, the Company and XCEL Corporation Limited, a second-tier wholly-owned subsidiary of the Company ("XCEL"), entered into an agreement ("Purchase Agreement") relating to the acquisition of Pascall Electronic (Holdings) Limited ("PEHL") by XCEL. The closing of the purchase occurred on March 18, 2005. The Company loaned to XCEL the funds that XCEL used to purchase PEHL.

PEHL was a wholly-owned subsidiary of Intelek Properties Limited, which itself is an operating subsidiary of Intelek PLC, a London Stock Exchange public limited company. PEHL and its subsidiary, Pascall Electronics Limited ("Pascall"), produce, design, develop, manufacture and sell power supplies and radio frequency products for a broad range of applications, including in-flight entertainment systems and military programs.

Under the Purchase Agreement, XCEL purchased all of the outstanding capital stock of PEHL. The initial purchase price was 3,100,000 British pounds sterling (approximately U.S. $5,972,000 based on the exchange rate in effect on March 18, 2005). The purchase price was paid in cash and is subject to upward or downward adjustment on a pound for pound basis to the extent that the value of the net assets of Pascall as of the closing date is greater or less than 2,520,000 British pounds sterling. The calculation of the value of the net assets of Pascall is to occur within six weeks after the closing, and Intelek Properties Limited will have 25 business days after receipt of the calculation to accept or dispute the calculation. Any payment relating to the increase or reduction of the purchase price based on the value of the net assets of Pascall will be due from XCEL or Intelek Properties Limited, as the case may be, within 14 days of the acceptance of the calculation. A default rate of interest equal to 3% above the base lending rate of Barclays Bank plc London will apply if the adjustment payment is not timely made. The purchase price is also subject to downward adjustments for any payments that may be made to XCEL under indemnity, tax or warranty provisions of the Purchase Agreement.

XCEL loaned to PEHL and Pascall at the closing 1,600,000 British pounds sterling (approximately U.S. $3,082,000 based on the exchange rate in effect on March 18, 2005) in accordance with the terms of a Loan Agreement entered into by

those entities at the closing. The loaned funds were used to immediately repay outstanding intercompany debt owed by PEHL and Pascall to Intelek Properties Limited.

The Company and Intelek PLC have agreed to guarantee payment when due of all amounts payable by XCEL and Intelek Properties Limited, respectively, under the Purchase Agreement. The Company and XCEL agreed to seek to replace the guaranty that Intelek Properties Limited has given to Pascall's landlord with a guaranty by the Company, and XCEL 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, non-interference with Pascall's customers and suppliers, and non-solicitation of Pascall's employees. In conjunction with the closing, Intelek Properties Limited, XCEL, Intelek PLC 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 U.S. $385,000 based on the exchange rate in effect on March 17, 2005) that was made by Intelek Properties Limited to Pascall on March 17, 2005 would be repaid by Pascall by March 31, 2005. XCEL agreed to ensure that Pascall has sufficient funds to repay the bridge loan. A default rate of interest equal to 3% above the base lending rate of Barclays Bank plc London will apply if the loan is not timely repaid.

The following table summarizes the unaudited assets acquired and liabilities assumed in connection with this acquisition, based on Pascall's balance sheet data at February 28, 2005:

	Dollars in Thousands
Current assets	$ 5,543
Property, plant and equipment	1,398
Intangibles, including goodwill	3,577
Other assets	152
Total assets acquired	10,669
Current liabilities	1,528
Other liabilities	117
Total liabilities assumed	1,645
Net assets acquired	$ 9,024

The following table summarizes, on an unaudited pro forma basis, the combined results of operations of the Company and Pascall, as though the Pascall acquisition occurred as of January 1, 2003. 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,	
	2004	2003
Revenues	$ 41,697	$ 38,540
Net income	1,655	1,308
Earnings per share of common stock:		
Basic	$ 0.07	$ 0.06
Diluted	$ 0.07	$ 0.05

EMRISE CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

Description	Balance at Beginning of Year	Additions Charged to Costs and Expenses	Deductions Write-offs of Accounts	Re Acq w Acqu
Allowance for doubtful accounts:				
Year ended December 31, 2004	$ 161,000	$ --	$ (32,000)	$
Year ended December 31, 2003	$ 130,000	$ 61,000	$ (30,000)	$
Year ended December 31, 2002	$ 226,000	$ 118,000	$ (214,000)	$
Allowance for inventory obsolescence:				
Year ended December 31, 2004	$1,692,000	$1,116,000	$ (557,000)	$
Year ended December 31, 2003	$1,497,000	$ 924,000	$ (729,000)	$
Year ended December 31, 2002	$1,152,000	$ 438,000	$ (93,000)	$

EMRISE CORPORATION

PROSPECTUS

, 2005

WE HAVE NOT AUTHORIZED ANY DEALER, SALESMAN OR OTHER PERSON TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION OTHER THAN THOSE CONTAINED IN THIS PROSPECTUS AND ANY ACCOMPANYING SUPPLEMENT TO THIS PROSPECTUS. YOU MUST NOT RELY UPON ANY INFORMATION OR REPRESENTATION NOT CONTAINED IN THIS PROSPECTUS OR ANY ACCOMPANYING PROSPECTUS SUPPLEMENT. THIS PROSPECTUS AND ANY ACCOMPANYING SUPPLEMENT TO THIS PROSPECTUS DO NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY SECURITIES OTHER THAN THE REGISTERED SECURITIES TO WHICH THEY RELATE, NOR DO THIS PROSPECTUS AND ANY ACCOMPANYING SUPPLEMENT TO THIS PROSPECTUS CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY SECURITIES IN ANY JURISDICTION TO ANY PERSON TO WHOM IT IS UNLAWFUL TO MAKE SUCH OFFER OR SOLICITATION IN SUCH JURISDICTION. THE INFORMATION CONTAINED IN THIS PROSPECTUS AND ANY ACCOMPANYING SUPPLEMENT TO THIS PROSPECTUS IS ACCURATE AS OF THE DATES ON THEIR COVERS. WHEN WE DELIVER THIS PROSPECTUS OR A SUPPLEMENT OR MAKE A SALE PURSUANT TO THIS PROSPECTUS OR A SUPPLEMENT, WE ARE NOT IMPLYING THAT THE INFORMATION IS CURRENT AS OF THE DATE OF THE DELIVERY OR SALE.

PART II

PART II: INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 13. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

The following table sets forth all expenses to be paid by the registrant in connection with this offering. All amounts shown are estimates except for the SEC registration fee.

SEC registration fee	$ 3,225
Legal fees and expenses	$150,000
Accounting fees and expenses	$ 90,000
Printing expenses	$ 5,000
Blue sky fees and expenses	$ 10,000
Transfer agent and registrar fees and expenses	$ --
Miscellaneous	$ 15,000
Total	$273,225

ITEM 14. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Section 145 of the Delaware General Corporation Law authorizes a court to award, or a corporation's board of directors to grant, indemnity to officers, directors and other corporate agents in terms sufficiently broad to permit indemnification under certain circumstances and subject to certain limitations, such as if such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the registrant, and with respect to any criminal proceeding, had no reasonable cause to believe such person's conduct was unlawful.

As permitted to Section 145 of the Delaware General Corporation Law, the registrant's amended and restated certificate of incorporation includes a provision that eliminates the personal liability of its directors of monetary damages for breach of their fiduciary duty as directors.

In addition, as permitted by Section 145 of the Delaware General Corporation Law, the bylaws of the registrant provide that:

- The registrant shall indemnify its directors and officers for serving the registrant in those capacities or for serving other business enterprises at the registrant's request, to the fullest extent permitted by Delaware law.

- The registrant may, in its discretion, indemnify employees and agents in those circumstances where indemnification is not required by law.

- The registrant is required to advance expenses, as incurred, to its directors and officers in connection with defending a proceeding, except that such director or officer shall undertake to repay such advance if it is ultimately determined that such person is not entitled to indemnification.

- The rights conferred in the bylaws are not exclusive, and the registrant is authorized to enter into indemnification agreements with its directors, officers, employees and agents and to obtain insurance to indemnify such persons.

- The Registrant may not retroactively amend the bylaw provisions to reduce its indemnification obligations to directors, officers, employees and agents.

The registrant's policy is to enter into separate indemnification agreements with each of its directors and officers that provide the maximum indemnity allowed to directors and officers by Section 145 of the Delaware General Corporation Law and which allow for additional procedural protections. The registrant also maintains directors' and officers' insurance to insure those persons against various liabilities.

Registration rights agreements between the registrant and various investors provide for cross-indemnification in connection with registration of the registration's common stock on behalf of those investors.

These indemnification provisions and the indemnification agreements entered into between the registrant and its officers and directors may be sufficiently broad to permit indemnification of the registrant's officers and directors for liabilities (including reimbursement of expenses incurred) arising under the Securities Act.

Reference is made to the following documents filed as exhibits to this registration statement regarding relevant indemnification provisions described above and elsewhere herein.

DOCUMENT	EXHIBIT NUMBER
Restated Certificate of Incorporation	3.01

Amended and Restated Bylaws	3.02
Form of Indemnification Agreement	10.40
Registration Rights Agreements	4.2 and 4.5

ITEM 15. RECENT SALES OF UNREGISTERED SECURITIES

In March 2002, the registrant issued an aggregate of 39,628 shares of common stock upon conversion of 3,962.8 shares of Series B Preferred Stock held by two individuals.

In April and May 2002, the registrant issued an aggregate of 756,742 shares of common stock upon conversion of 75,674.2 shares of Series B Preferred Stock held by four individuals and three entities.

In July 2002, the registrant issued an aggregate of 46,293 shares of common stock upon conversion of 4,629.3 shares of Series B Preferred Stock held by one entity.

In September 2002, the registrant issued to a former employee for advice and consultation services valued at $6,000, three-year warrants to acquire 120,000 shares of our common stock at an exercise price of $0.50 per share.

In November 2002, the registrant issued 5,000 shares of common stock with an aggregate value of $1,000 to a former employee for services rendered.

In December 2002, the registrant issued an aggregate of 16,759 shares of common stock to two holders of Series B Preferred Stock upon conversion of 1,675.9 shares of Series B Preferred Stock.

In March 2003, the registrant issued 41,663 shares of common stock to one investor upon conversion of 4,166.3 shares of Series B Preferred Stock.

In April 2003, the registrant issued to two individuals three-year warrants to purchase up to 150,000 shares of common stock at a per share exercise price of $0.75 and up to 100,500 shares of common stock at a per share exercise price of $1.00 in consideration for financial advisory services rendered.

In May and June 2003, the registrant issued an aggregate of 587,286 shares of common stock to five investors upon conversion of 58,728.6 shares of Series B Preferred Stock.

In May and June 2003, the registrant issued an aggregate of 1,263,250 shares of common stock to four investors upon conversion of 25 shares of Series A Preferred Stock.

In September 2003, the registrant issued an aggregate of 5,926 shares of common stock to two investors upon conversion of 52.6 shares of Series B Preferred Stock.

In January 2004, the registrant issued 3,703 shares of common stock to an investor upon conversion of shares of Series B Convertible Preferred Stock.

On July 13, 2004, the registrant issued 1,213,592 shares of common stock and warrants to purchase up to an aggregate of 150,000 shares of common stock at $1.30 per share to two trusts as part of the purchase price for the

acquisition of Larus Corporation pursuant to a Stock Purchase Agreement.

On November 3, 2004, the registrant issued to one entity warrants to purchase an aggregate of 100,000 shares of common stock at exercise prices ranging from $0.85 to $1.15 per share as partial consideration for investor relations services. On January 24, 2005, the registrant issued to this same entity additional warrants to purchase 25,000 shares of common stock at an exercise price of $2.00 per share, again as partial consideration for investor relations services.

In December 2004, the registrant issued 15,000 shares of common stock to one individual upon exercise of a warrant with an aggregate exercise price of $3,750.

In January 2005, the registrant issued 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 common stock at an exercise price of $1.73 per share in a private offering to 17 record holders pursuant to a Securities Purchase Agreement. The registrant also entered into a Registration Rights Agreement in which it agreed to register for resale the shares of common stock issued to investors and the shares of common stock issuable upon exercise of the investor warrants and placement warrants. Additionally, the registrant paid cash placement agent fees and expenses of approximately $961,000 and issued a five-year placement agent warrant to purchase up to 650,310 shares of common stock at an exercise price of $1.73 per share.

In March 2005, the registrant issued to one entity a three-year warrant to purchase up to 85,000 shares of common stock at an exercise price of $1.86 per share as partial consideration for financial advisory services.

The issuances of our securities described above were made in reliance upon the exemption from registration available under Section 4(2) of the Securities Act, among others, as transactions not involving a public offering. This exemption was claimed on the basis that these transactions did not involve any public offering and the purchasers in each offering were accredited or

sophisticated and had sufficient access to the kind of information registration would provide. In each case, appropriate investment representations were obtained and stock certificates were issued with restrictive legends.

ITEM 16. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) EXHIBITS.

The following exhibits are included or incorporated herein by reference.

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)

3.1	Restated Certificate of Incorporation of Emrise Corporation filed with the Secretary of State of Delaware on December 8, 2004 (2)
3.2	Amended and Restated Bylaws adopted by the Board of Directors of the Corporation on September 1, 2004 (3)
4.1	Securities Purchase Agreement dated December 29, 2004 among Emrise Corporation and the investors listed on an attachment thereto (4)
4.2	Registration Rights Agreement dated December 29, 2004 among Emrise Corporation and the investors who are parties to the Securities Purchase Agreement listed as Exhibit 4.1 (4)
4.3	Form of Investor Warrant issued by Emrise Corporation to the investors who are parties to the Securities Purchase Agreement listed as Exhibit 4.1 (4)
4.4	Form of Placement Warrant issued by Emrise Corporation to Roth Capital Partners, LLC covering 650,310 shares of common stock (4)
4.5	Registration Rights Agreement dated July 13, 2004 among the Registrant and 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 *
4.6	Form of Common Stock Purchase Warrant dated July 13, 2004 issued by the Registrant to: (a) Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995 (84,066 shares); and (b) Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (65,934 shares) *
4.7	Warrants to Purchase Common Stock dated November 3, 2004 issued by the Registrant to Hayden Communications, Inc. (100,000 shares) *
4.8	Warrants to Purchase Common Stock dated January 24, 2005 issued by the Registrant to Hayden Communications, Inc. (25,000 shares) *
4.9	Warrants to Purchase Common Stock dated April 3, 2001 issued by the Registrant to Coffin Partners LLC (35,000 shares) *
4.10	Warrants to Purchase Common Stock dated September 25, 2002 issued by the Registrant to Jacques Moisset (120,000 shares) *

EXHIBIT NUMBER	DESCRIPTION
4.11	Form of Warrants to Purchase Common Stock dated April 2, 2003 issued by the Registrant to: (a) Jason Oliva (100,000 shares at $0.75 per share); (b) Jason Oliva (100,500 shares at $1.00 per share); (c) Steven Jacobus (50,000 shares at $0.75 per share);

	and (d) George Farndell (150,000 shares at $0.75) *
5	Opinion of Rutan & Tucker, LLP (17)
10.1	1993 Stock Option Plan (#) (6)
10.2	Employee Stock and Stock Option Plan (#) (7)
10.3	1997 Stock Incentive Plan (#) (8)
10.4	Amended and Restated 2000 Stock Option Plan (#) (9)
10.5	Form of Incentive Stock Option Agreement Under Amended and Restated 2000 Stock Option Plan (#) (5)
10.6	Form of Non-Qualified Stock Option Agreement Under Amended and Restated 2000 Stock Option Plan (#) (5)
10.7	Credit Facility Letter Agreement dated June 1, 2004 between Wells Fargo Bank, N.A., XET Corporation and CXR Telcom Corporation (10)
10.8	Revolving Line of Credit Note dated June 1, 2004 in the principal amount of up to $3,000,000 made by XET Corporation and CXR Telcom Corporation in favor of Wells Fargo Bank, N.A. (10)
10.9	Term Note dated June 1, 2004 in the principal amount of $150,000 made by XET Corporation and CXR Telcom Corporation in favor of Wells Fargo Bank, N.A. (10)
10.10	Continuing Guaranty made by XET Corporation and CXR Telcom Corporation in favor of Wells Fargo Bank, N.A. (10)
10.11	Security Agreement Equipment made by XET Corporation in favor of Wells Fargo Bank, N.A. (10)
10.12	Security Agreement Equipment made by CXR Telcom Corporation in favor of Wells Fargo Bank, N.A. (10)
10.13	Continuing Security Agreement Rights to Payment and Inventory made by XET Corporation in favor of Wells Fargo Bank, N.A. (10)
10.14	Continuing Security Agreement Rights to Payment and Inventory made by CXR Telcom Corporation in favor of Wells Fargo Bank, N.A. (10)
10.15	Deed of Guarantee and Indemnity dated November 12, 2002 made by MicroTel International Inc., XCEL Corporation Limited, Belix Power Conversion Limited and Belix Wound Components Limited in favor of Venture Finance PLC (11)
10.16	Advantage Facility dated November 12, 2002 between XCEL Power Systems Limited and Venture Finance PLC (11)
10.17	Cashflow Loan Agreement dated November 12, 2002 between XCEL Power Systems Limited and Venture Finance PLC (11)
10.18	Term Loan Agreement dated November 12, 2002 between XCEL Power Systems Limited and Venture Finance PLC (11)

EXHIBIT NUMBER	DESCRIPTION
10.19	Deed of Subordination dated November 12, 2002 between Venture Finance PLC, MicroTel International Inc. and XCEL Corporation Limited (11)
10.20	Agreement for the Purchase of Debts dated November 12, 2002 between XCEL Power Systems Limited and Venture Finance PLC (11)
10.21	Letter Agreement dated October 23, 2002 between XCEL Power Systems Limited and Venture Finance PLC regarding Amendments to Agreement for the Purchase of Debts (11)
10.22	Credit Facility Agreement dated April 8, 2003, between IFN Finance and CXR, S.A.S. (11)
10.23	English Summary of Credit Facility Agreement dated April 8, 2003 between IFN Finance and CXR, S.A.S. (12)
10.24	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)
10.25	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)
10.26	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)
10.27	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)
10.28	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)
10.29	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)
10.30	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)
10.31	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)

EXHIBIT NUMBER	DESCRIPTION
10.32	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)
10.33	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)
10.34	Lease agreement between the Registrant and Property Reserve Inc. dated September 16, 1999 (13)
10.35	Lease agreement between XET, Inc. and Rancho Cucamonga Development dated August 30, 1999 (13)
10.36	Commercial Lease dated July 13, 2004 between MicroTel International Inc., as Tenant, and Noel C. McDermott and Warren P. Yost, as Landlord, for the premises located at 894 Faulstich Court, San Jose, California (10)
10.37	Employment Agreement dated as of January 1, 2001 between the Registrant and Carmine T. Oliva (#) (14)
10.38	Employment Agreement dated as of July 2, 2001 between the Registrant and Randolph D. Foote (#) (9)
10.39	Employment Agreement dated as of January 1, 2001 between the Registrant and Graham Jefferies (#) (9)
10.40	Form of Executive Officer and Director Indemnification Agreement entered into between the Registrant and each of Carmine T. Oliva, Robert B. Runyon, Laurence P. Finnegan, Jr., Otis W. Baskin, Randolph D. Foote and Graham Jefferies (2)
10.41	Description of Retirement Account Matching Contributions (#) (5)
21	Subsidiaries of the Registrant (5)
23.1	Consent of Grant Thornton LLP, Independent Registered Public Accounting Firm *

23.2 Consent of Rutan & Tucker, LLP (contained in Exhibit 5) (17)

24 Power of Attorney (contained on the signature page to the initial filing of this registration statement)

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* 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.

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(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 December 29, 2004 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, 2004 and incorporated herein by reference.

(6) 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.

(7) 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.

(8) 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.

(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.

(15) Filed as an exhibit to the Registrant's registration statement on Form S-8 (Registration Statement No. 333-29925) and incorporated herein by reference.

(16) Filed as an exhibit to the initial filing of the Registrant's registration statement on Form S-1 (Registration Statement No. 333-63024)

and incorporated herein by reference.

(17) To be filed by amendment.

(b) FINANCIAL STATEMENT SCHEDULES

The following financial statement schedule required to be filed by Item 16(b) is contained on page F-51 of this registration statement.

Consolidated Schedule II Valuation and Qualifying Accounts for the Years Ended December 31, 2004, 2003 and 2002

All other schedules have been omitted because they are either inapplicable or the required information has been given in the consolidated financial statements or notes thereto.

ITEM 17. UNDERTAKINGS

The undersigned registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20 percent change in the maximum aggregate offering price set forth in the "Calculation of Registration fee" table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial BONA FIDE offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

The undersigned registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in the form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For purposes of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the provisions described in Item 14 hereof, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act, and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question of whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this amendment no. 1 to registration statement on Form S-1 to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Rancho Cucamonga, State of California, on April 12, 2005.

EMRISE CORPORATION

By: /s/ Carmine T. Oliva

Carmine T. Oliva
Chairman of the Board, President
and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this amendment no. 1 to registration statement has been signed by the following persons in the capacities and on the dates indicated.

NAME TITLE

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/s/ Carmine T. Oliva Carmine T. Oliva	Chairman of the Board, President, Chief Executive Officer (principal executive officer) and Director	Ap
/s/ Carmine T. Oliva Carmine T. Oliva	Acting Chief Financial Officer (principal accounting and financial officer)	Ap
/s/ Robert B. Runyon* Robert B. Runyon	Director	Ap
/s/ Laurence P. Finnegan, Jr.* Laurence P. Finnegan, Jr.	Director	Ap
/s/ Otis W. Baskin* Otis W. Baskin	Director	Ap

* By: /s/ Carmine T. Oliva
Carmine T. Oliva,
Attorney-in-Fact

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INDEX TO EXHIBITS ATTACHED TO THIS AMENDMENT NO. 1 TO FORM S-1

Exhibit Number	Description
4.5	Registration Rights Agreement dated July 13, 2004 among the Registrant and 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
4.6	Form of Common Stock Purchase Warrant dated July 13, 2004 issued by the Registrant to: (a) Noel C. McDermott, as Trustee of the Noel C. McDermott Revocable Living Trust dated December 19, 1995 (84,066 shares); and (b) Warren P. Yost and Gail A. Yost, as Co-Trustees Under Declaration of Trust dated March 9, 1988 (65,934 shares)
4.7	Warrants to Purchase Common Stock dated November 3, 2004 issued by the Registrant to Hayden Communications, Inc. (100,000 shares)
4.8	Warrants to Purchase Common Stock dated January 24, 2005 issued by the Registrant to Hayden Communications, Inc. (25,000 shares)

4.9	Warrants to Purchase Common Stock dated April 3, 2001 issued by the Registrant to Coffin Partners LLC (35,000 shares)
4.10	Warrants to Purchase Common Stock dated September 25, 2002 issued by the Registrant to Jacques Moisset (120,000 shares)
4.11	Form of Warrants to Purchase Common Stock dated April 2, 2003 issued by the Registrant to: (a) Jason Oliva (100,000 shares at $0.75 per share); (b) Jason Oliva (100,500 shares at $1.00 per share); (c) Steven Jacobus (50,000 shares at $0.75 per share); and (d) George Farndell (150,000 shares at $0.75)
23.1	Consent of Grant Thornton LLP, Independent Registered Public Accounting Firm