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PORTA SYSTEMS CORP  
Form 10-K  
April 02, 2001

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]

For the fiscal year ended December 31, 2000

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-8191

PORTA SYSTEMS CORP.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization) 11-2203988  
(IRS Employer  
Identification No.)

575 Underhill Boulevard, Syosset, New York 11791  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (516) 364-9300

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

Common Stock, par value \$.01 American Stock Exchange  
(Title of Class) (Name of Exchange on which registered)

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

None

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

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

State aggregate market value of the voting stock held by non-affiliates of the registrant: \$3,449,620 as of March 16, 2001.

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Indicate the number of shares outstanding of each of the registrant's class of common stock, as of the latest practicable date: 9,856,056 shares of Common Stock, par value \$.01 per share, as of March 16, 2001.

### DOCUMENTS INCORPORATED BY REFERENCE

The registrant's definitive proxy statement in connection with its 1999 Annual Meeting of Stockholders to be filed within 120 days of the close of the registrant's fiscal year is incorporated by reference into Part III of the Report.

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#### Item 1. Business

Porta Systems Corp. develops, designs, manufactures and markets a broad range of standard and proprietary telecommunications equipment and integrated software applications for sale domestically and internationally. Our core products, focused on ensuring communications for service providers worldwide, fall into three categories:

Computer-based operation support systems. Our operation support systems, which we call our OSS systems, focus on the access loop and are components of telephone companies' service assurance and service delivery initiatives. The Systems primarily focus on trouble management, line testing, network provisioning, inventory and assignment, and automatic activation, and most currently single ended line qualification for the delivery of xDSL high bandwidth services. We market these systems principally to foreign telephone operating companies in established and developing countries primarily in Asia, South and Central America and Europe.

Telecommunications connection and protection equipment. These systems are used to connect copper-wired telecommunications networks and to protect telecommunications equipment from voltage surges. We market our copper connection equipment and systems to telephone operating companies and customer premise systems providers in the United States and foreign countries.

Signal processing equipment. These products, which we sell principally for use in defense and aerospace applications, support copper wire-based communications systems.

Porta Systems Corp. is a Delaware corporation incorporated in 1972 as the successor to a New York corporation incorporated in 1969. Our principal offices are located at 575 Underhill Boulevard, Syosset, New York 11791; telephone number, 516-364-9300. References to Porta include its subsidiaries, unless the context indicates otherwise.

#### Forward-Looking Statements

The statements in this Form 10-K Annual Report that are not descriptions of historical facts may be forward looking statements that are subject to risks and uncertainties. In particular, statements in this Form 10-K Annual Report, including any material incorporated by reference in this Form 10-K, that state our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions are forward-looking statements. Forward-looking statements are subject to risks, uncertainties and other factors, including, but not limited to, those identified under Risk Factors, and those described in Management's Discussion and Analysis of Financial Condition and Results of Operations and in any other filings we make with the Securities and Exchange Commission, as well

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as general economic conditions, any one or more of which could cause actual results to differ materially from those stated in such statements.

### Risk Factors

We recently incurred net losses from our operations, and our losses may continue. We incurred a net loss of \$10,176,000, or \$1.04 per share (basic and diluted), on sales of \$51,140,000 for 2000 following a loss of \$13,686,000, or \$1.44 per share (basic and diluted) for 1999, and our losses are continuing at least through the first quarter of 2001 and may continue thereafter. We cannot give assurance that we will be able to operate profitably in the future.

Our independent auditors have included an explanatory paragraph relating to our ability to continue as a going concern in their report on our financial statements. Because of our substantial losses in 2000 and 1999, our stockholders' deficit of \$ 10,792,000 at December 31, 2000, and our working capital deficit of \$24,152,000 as of December 31, 2000, resulting primarily from approximately \$27,000,000 of debt maturing in July 2001, our auditors included in their report an explanatory paragraph about our ability to continue as a going concern.

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We require substantial financing to meet our working capital requirements. We had a working capital deficit at December 31, 2000 of \$24,152,000, compared to working capital of \$6,135,000 at December 31, 1999. As of December 31, 2000, our current liabilities include \$20,746,000 due to our senior lender, all of which is due and payable on July 3, 2001, at which time our agreement with the senior lender will terminate. At December 31, 2000, we did not have sufficient resources to pay the senior lender at maturity and we do not expect to generate the necessary cash from our operations to enable us to make that payment. In addition, \$6,144,000 of subordinated notes were outstanding as of December 31, 2000 of which \$900,000 matured on January 3, 2001 and \$5,244,000 will mature on July 3, 2001. We did not have sufficient resources to pay the principal portion which matured on January 3, 2001 or the interest which was due on the subordinated notes on January 3, 2001, and we failed to make the scheduled principal and interest payments on the subordinated debt. We cannot give any assurance that we will be able to either pay our obligations to our senior or subordinated lenders at their respective maturity dates or renew our agreement with our senior lender or enter into an agreement with a new lender. At December 31, 2000, we were in default on a covenant on our agreement with our senior lender and the outstanding advances from the senior lender exceeded the maximum allowable under the borrowing base formula since the Company's eligible assets were not sufficient to support the outstanding balance under the combined revolving advance and standby letters of credit guarantee (see Note 6, Notes to Consolidated Financial Statements). The senior lender waived the default and permitted us to continue to maintain the over advance through July 2, 2001. We cannot assure you that any future defaults will be waived, in which event the principal and interest on our obligations to our senior lender may become immediately due and payable. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

We are heavily dependent on foreign sales. Approximately 66% of our sales in 2000, 62% of our sales in 1999 and 60% of our sales for 1998, were made to foreign telephone operating companies. In selling to customers in foreign countries, we are exposed to inherent risks not normally present in the case of our sales to United States customers, including extended delays in both completing the installation and receiving the final payment from our customers for our Operational Support Systems contracts, and as well as further risks relating to political and economic changes.

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We rely heavily on British Telecommunications for most of our sales. During 2000, our direct sales to British Telecommunications were \$5,098,000, or approximately 10% of our sales. Pursuant to our agreement with Fujitsu Telecommunications Europe LTD, which purchases telecommunications equipment from us for sale to British Telecommunications, our sales to Fujitsu Telecommunications for 2000 were \$12,051,000 or 24% of sales. Our largest customer in both 1999 and 1998 was British Telecommunications. Sales to British Telecommunications for 1999 were \$7,825,000, or approximately 20% of sales, and sales in 1998 were \$15,349,000, or 26% of sales. Therefore, any significant interruption or decline in sales to either British Telecommunications or Fujitsu Telecommunications may have a materially adverse effect upon our operations.

We have granted to British Telecommunications rights to our technology. Under our agreement with British Telecommunications, we gave British Telecommunications the right to use our connection/protection technology or have products using our technology manufactured for it by others. As a result, British Telecommunication may have the right to use our technology and purchase products based on our technology from others, which may result in a significant decline in our sales to British Telecommunications. Furthermore, we are currently negotiating a supply agreement with British Telecommunication. There are no assurances that we will be successful in securing a new agreement. If we do not enter into a new agreement with British Telecommunications, our business may be impaired.

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We experience difficulties with Operations Support Systems contracts. We experience delays in purchaser acceptance of the Operations Support Systems and our receipt of final contract payments in connection with a number of foreign sales. In addition, we have no steady or predictable flow of orders for Operations Support Systems and the negotiation of a contract for an operations support system is an individualized and highly technical process. These contracts typically contain performance guarantees by us and clauses imposing penalties on us if we do not meet the contractual in-service dates. The installation, testing and purchaser acceptance phases of these contracts may last longer than contemplated by the contracts and, accordingly, amounts due under the contracts may not be collected for extended periods. Furthermore, our Operation Support Systems contracts typically contain performance guarantees by us and clauses imposing penalties if we do not meet "in-service" dates.

Because of our small size and our financial problems, we may have difficulty competing for business. We compete directly with a number of large and small telephone equipment manufacturers in the United States, with Lucent Technologies, Inc. continuing to be our principal United States competitor. In the past, competitors have used our financial difficulties in successfully competing against us. We anticipate that our loss for 2000, our working capital deficiency and the scheduled expiration of our financing agreement may continue to place us in a competitive disadvantage, particularly in seeking Operations Support Systems contracts, where we frequently deal with national telecommunications companies.

We face significant competition for both foreign and domestic sales. In both foreign and domestic markets, we face considerable competition from other United States and foreign telephone equipment manufacturers most of which are larger and have substantially greater financial resources than us. In addition, if we establish facilities in foreign countries, we face risks associated with currency devaluation, difficulties in either converting local currency into dollars or transferring funds to the United States, local tax and currency regulations and political instability.

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We require access to current technological developments. We rely primarily on the performance and design characteristics of our products and we try to offer our products at prices and with warranties that will make our products competitive. Our business could be adversely affected if we cannot obtain licenses for such updated technology or self develop state-of-the-art technology.

We rely on certain key employees. We may be dependent upon the continued employment of certain key employees, including our senior executive officers. Our failure to retain such employees may have a material adverse effect upon our business.

We do not pay dividends on common stock. We have not paid dividends on our common stock and do not anticipate paying dividends in the foreseeable future. We presently intend to retain future earnings, if any, in order to provide funds for use in the operation of our business and repayment of debt and, accordingly, do not anticipate paying cash dividends on our common stock in the foreseeable future. In addition, our agreement with our senior secured lender prohibits payment of dividends.

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### Products

Operations Support Systems. We sell our OSS systems primarily to telephone operating companies in established and developing countries in Asia, South and Central America and Europe, and to a lesser extent, in the United States. Our principal OSS systems are computer-based testing, provisioning, activation and trouble management products which include software and capital equipment and typically sell for prices ranging from several hundred thousand to several million dollars.

The testing products are designed to automatically test for and diagnose problems in customer telephone lines and to notify telephone company service personnel of required maintenance. The associated trouble management system provides automated record keeping (including repair and disposition records) and analyzes these records to enable the telephone company to identify recurring problems and equipment deterioration and to fulfill maintenance service level agreement obligations. The integration of these systems provides a service assurance function for telephone companies.

A major component of the testing system is the "test head," which provides the access to, and tests the required telephone line. We have continually developed our test head capability to meet the changing requirements of the customer loop, and have recently introduced our latest advanced technology platform (sixth generation) product, the MKIII. An enhanced version of the MKIII, the Sherlock, will provide the capability to determine whether customer lines are xDSL capable, enabling telephone companies to expeditiously characterize their outside plant, and optimize their responsiveness to market conditions.

Our other software applications, including the automated assignment of facilities and activation of service, form part of a telephone company's service activation function, and can be integrated with the testing and trouble management systems, to provide a comprehensive access loop capability. In addition, if requested by customers, Porta develops software to meet specific customer requirements, including integration of its systems with telephone company legacy or third party OSS systems.

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We have entered into a number of agreements with suppliers of complementary products and plans to offer those products through our distribution channels to our customer base. Those products enhance the customers' service delivery and service assurance initiatives and address specific operations areas such as facility and records verification and purification, work force scheduling and task mapping, and call fraud detection.

Our OSS products are complex and, in most applications, incorporate features designed to respond to the purchaser's operational requirements and the particular characteristics of the purchaser's telephone system and operational processes. As a result, the negotiation of a contract for an OSS system is an individualized and highly technical process. In addition, contracts for OSS systems frequently provide for manufacturing, delivery, installation, testing and purchaser acceptance phases, which take place over periods ranging from several months to a year or more. These contracts typically contain performance guarantees by us and clauses imposing penalties if "in-service" dates are not met. The installation, testing and purchaser acceptance phases of these contracts may last longer than contemplated by the contracts and, accordingly, amounts due under the contracts may not be collected for extended periods and, in some instances, may not be collected. Delays in purchaser acceptance of the systems and in our receipt of final contract payments have occurred in connection with a number of foreign sales. In addition, we have not experienced a steady or predictable flow of orders for OSS systems.

Telecommunications Connection Equipment. Our copper connection/protection equipment and systems are used by telephone operating companies, by owners of private telecommunications equipment and by manufacturers and suppliers of telephone central office and customer premises equipment. Products of the types comprising our telecommunications connection equipment are included as integral parts of all domestic and foreign telephone and telecommunications systems. Such products are sold in a worldwide market, which generally grows in proportion to increases in the number of telephone subscribers and owners of private telecommunications equipment, as well as to increases in upgrades to modern digital switching technology such as DSL, ADSL, and ISDN lines.

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Our connection equipment consists of connector blocks and protection modules used by telephone companies to interconnect copper-based subscriber lines to switching equipment lines. The protector modules protect central office personnel and equipment from electrical surges. The need for protection products has increased as a result of the worldwide move to digital technology, which is extremely sensitive to damage by electrical overloads, and because private owners of telecommunications equipment now have the responsibility to protect their equipment from damage caused by electrical surges. Line connecting/protecting equipment usually incorporates protector modules to safeguard equipment and personnel from injury due to power surges. Currently, these products include a variety of connector blocks, protector modules and frames used in telephone central switching offices, PBX installations, multiple user facilities and customer premise applications.

We also have developed an assortment of frames for use in conjunction with our traditional line of connecting/protecting products. Frames for the interconnection of copper circuits are specially designed structures which, when equipped with connector blocks and protectors, interconnect and protect telephone lines and distribute them in an orderly fashion allowing access for repairs and changes in line connections. One of our frame products, the CAM frame, is designed to produce computer-assisted analysis for the optimum placement of connections for telephone lines and connector blocks mounted on the frame.

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Our copper connection/protection products are used by many of the Regional Bell Operating Companies as well as by independent telephone operating companies in the United States and owners of private telecommunications equipment. These products are also purchased by other companies for inclusion within their systems. In addition, our telecommunications connection products have been sold to telephone operating companies in various foreign countries. This equipment is compatible with existing telephone systems both within and outside the United States and can generally be used without modification, although we do custom design modifications to accommodate the specific needs of our customers.

**Signal Processing Products.** Our signal processing products include data bus systems and wideband transformers. Data bus systems, which are the communication standard for military and aerospace systems, require an extremely high level of reliability and performance. Wideband transformers are required for ground noise elimination in video imaging systems and are used in the television and broadcast, medical imaging and industrial process control industries.

The table below shows, for the last three fiscal years, the contribution made to our sales by each of its major categories of the telecommunications industry:

Sales by Product Category						
Years Ended December 31,						
	2000		1999		1998	
	----		----		----	
(Dollars in thousands)						
OSS Systems	\$22,296	44%	\$14,254	37%	\$27,318	46%
Line Connecting /Protecting Equipment	20,546	40%	18,189	47%	24,291	41%
Signal Processing	7,644	15%	6,328	16%	7,539	13%
Other	654	1%	165	0%	195	0%
	-----	---	-----	---	-----	---
<b>Total</b>	<b>\$51,140</b>	<b>100%</b>	<b>\$38,936</b>	<b>100%</b>	<b>\$59,343</b>	<b>100%</b>
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### Markets

We supply equipment and systems to telephone companies which provides improved services to ensure communication to their customers. In addition, we provide businesses with systems which improve their internal telecommunication systems.

Telephone networks in certain regions of the world, notably Latin America, Eastern Europe and certain areas in the Asia/Pacific region, were designed to carry voice traffic and are not well suited for high-speed data transmissions or for other forms of telecommunications that operate more effectively with digital telecommunications equipment and lines. The telephone networks in these countries are also characterized by a very low ratio of telephone lines to population. Countries with emerging telecommunication networks have to rapidly

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add access lines in order to increase the availability of telephone service and to significantly upgrade the quality of the lines already in service.

Our OSS systems are designed to meet many of the needs of a rapidly changing telephone network. OSS systems facilitate rapid change and expansion without a comparable increase in the requirement for skilled technicians, while the computerized line test system insures increased quality and rapid maintenance and repair of subscriber local loops. The automated database, which computerizes the inventory and maintenance history of all subscriber lines in service, helps to keep the rapid change under control.

During 2000, approximately 44% of our sales consisted of OSS products and services.

As a telephone company expands the number of its subscriber lines, it also requires additional connection equipment to interconnect and protect those lines in its central offices. We provide a line of copper connection equipment for this purpose. Recent trends towards the transmission of high frequency signals on copper lines are sustaining this market. Less developed countries, such as those with emerging telecommunications networks or those upgrading to digital switching systems, provide a growing market for copper connection and protection equipment.

The increased sensitivity of the newer digital switches to small amounts of voltage requires the telephone company which is upgrading its systems to digital switching systems to also upgrade its central office connection/protection systems in order to meet these more stringent protection requirements. We supply central office connection/protection systems to meet these needs.

During 2000, approximately 40% of our sales were made to customers in this category.

Our line of signal processing products is supplied to customers in the military and aerospace industry as well as manufacturers of medical equipment and video systems. The primary communication standard in new military and aerospace systems is the MIL-STD-1553 Command Response Data Bus, an application which requires an extremely high level of reliability and performance. Products are designed to be application specific to satisfy the requirements of each military or aerospace program.

Our wideband transformers are required for ground noise elimination in video imaging systems and are used in the television and broadcast, medical imaging and industrial process control industries. If not eliminated, ground noise caused by poor electrical system wiring or power supplies, results in significant deterioration in system performance, including poor picture quality and process failures in instrumentation. The wideband transformers provide a cost effective and quick solution to the problem without the need of redesign of the rest of the system.

During 2000, signal processing equipment accounted for approximately 15% of our sales.

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### Marketing and Sales

Porta operates through three business units, which are organized by product line, and with each having responsibility for the sales and marketing of its products.



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When appropriate to obtain sales in foreign countries, we may enter into business arrangements and technology transfer agreements covering our products with local manufacturers and participate in manufacturing and licensing arrangements with local telephone equipment suppliers.

In the United States and throughout the world, we use independent distributors in the marketing of all copper based products to the regional bell operating companies and the customer premises equipment market. All distributors marketing copper-based products also market directly competing products. In addition, Porta continues to promote the direct marketing relationships it developed in the past with telephone operating companies.

We have an agreement with British Telecommunications covering our connecting/protecting products. This agreement which will expire on August 31, 2001 provides, among other things, that we are a non-exclusive supplier to British Telecommunications for these products. British Telecommunications purchased line connecting/protecting products amounting to \$4,261,000 (8% of sales) in 2000, \$6,566,000 (17% of sales) in 1999, and \$11,345,000 (19% of sales) in 1998. During these years, we also sold our products to unaffiliated suppliers for resale to British Telecommunications. Our agreement with British Telecommunications provides for a cross license which, in effect, enables British Telecommunications to use certain of our proprietary information to modify or enhance products provided to British Telecommunications and permits British Telecommunications to manufacture or engage others to manufacture those products. We are currently negotiating a new multi-year agreement with British Telecommunications. There are no assurances that we will be successful in securing a new agreement. If we do not enter into a new agreement British Telecommunications, our business could be impaired.

Our OSS systems historically have been sold to foreign telephone operating companies which are government controlled. Recently, we entered into sales, marketing and management co-operative agreements and strategic alliances with various companies.

During 2000, we entered into a multi-year sales, marketing, and management co-operative agreement with Fujitsu Telecommunications to market Internet infrastructure products. Under the agreement, Fujitsu will sell and market Porta's advanced Internet infrastructure technologies, including ADSL Single Ended Line Qualification System for broadband services and the sixth generation Sherlock remote test unit to telecom service operators in the United Kingdom, principally British Telecommunications, and certain other European countries.

Our signal processing products are sold primarily to US military and aerospace prime contractors, and domestic original equipment manufacturers and end users.

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The following table sets forth for the last three fiscal years our sales to customers by geographic region:

### Sales to Customers By Geographic Region (1)

	Year Ended December 31, -----		
2000 ----	1999 ----	1998 ----	
(Dollars in thousands)			

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North America	\$22,795	45%	\$14,664	38%	\$20,830	35%
United Kingdom	20,244	40%	15,673	40%	20,441	34%
Asia/Pacific	5,429	10%	4,159	11%	7,181	12%
Other Europe	2,482	5%	3,130	8%	3,377	6%
Latin America	146	0%	1,257	3%	7,463	13%
Middle East	25	0%	47	0%	51	0%
Other	19	0%	6	0%	--	0%
	-----	---	-----	---	-----	---
Total Sales	\$51,140	100%	\$38,936	100%	\$59,343	100%
	=====	===	=====	===	=====	===

(1) For information regarding the amount of sales, operating profit or loss and identifiable assets attributable to each of our divisions and geographic areas, see Note 22 of Notes to the Consolidated Financial Statements.

In selling to customers in foreign countries, there are inherent risks not normally present in the case of sales to United States customers, including increased difficulty in identifying and designing systems compatible with purchasers' operational requirements; extended delays under OSS systems contracts in the completion of testing and purchaser acceptance phases and difficulty in our receipt of final payments and political and economic change. In addition, to the extent that Porta establishes facilities in foreign countries, the Company faces risks associated with currency devaluation, inability to convert local currency into dollars, local tax regulations and political instability.

#### Manufacturing

Our computer-based testing products include proprietary testing circuitry and computer programs, which provide platform-independent solutions based on UNIX or UNIX compatible operating systems. The testing products also incorporate disk data storage, teleprinters, minicomputers and personal computers purchased by us. These products are installed and tested by us at our customers' premises.

At present, our manufacturing operations are conducted at facilities located in Glen Cove, New York and Matamoros, Mexico. From time to time we also use subcontractors to augment various aspects of our production activities and periodically explore the feasibility of conducting operations at lower cost manufacturing facilities located abroad. In selling to foreign telephone companies, we may be required to provide local manufacturing facilities and, in conjunction with these facilities, we may grant the facility a license to our proprietary technology.

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#### Source and Availability of Components

We generally purchase the standard components used in the manufacture of our products from a number of suppliers. Porta attempts to assure itself that the components are available from more than one source. We purchase all of our MKIII test units from two suppliers. We purchase the majority of our

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workstations and servers used in its OSS systems from Compaq Computer Corporation. However, we could use other computer equipment in our systems if we were unable to purchase Compaq products. Other components, such as personal computers and line printers used in connecting with our electronic products, are readily available from a number of sources.

### Significant Customers

During 2000, our five largest customers accounted for sales of \$28,323,000, or approximately 55% of sales, and, during 1999, our five largest customers accounted for sales of \$19,700,000, or approximately 51% of sales. Our largest customer in 2000 with sales of \$12,051,000, or approximately 24% of sales was Fujitsu Telecommunications. A significant amount of sales of our products for use by British Telecommunications were sold to Fujitsu Telecommunications, as purchasing agent for British Telecommunications. As a result, most of the sales to Fujitsu Telecommunications were for use by British Telecommunications. Our largest customer in 1999 was British Telecommunications. Direct sales to British Telecommunications were \$5,098,000, or 10% of sales, for 2000 and \$7,825,000, or 20% of sales, for 1999. Any significant interruption or decline in sales to Fujitsu Telecommunications or British Telecommunications may have a materially adverse effect upon our operations. During 2000, sales to a Mexican telephone company were \$5,507,000, or approximately 11% of sales. No other customers account for 10% or more of our sales for either year.

The former Bell operating companies continue to be the ultimate purchasers of a significant portion of our products sold in the United States, while sales to foreign telephone operating companies constitute the major portion of our foreign sales. Our contracts with these customers require no minimum purchases by such customers. Significant customers for the signal processing products include major US aerospace companies, the Department of Defense and original equipment manufacturers in the medical imaging and process control equipment industries. We sell both catalog and custom designed products to these customers. Some contracts are multi-year procurements.

### Backlog

At December 31, 2000, our backlog was approximately \$10,000,000 compared with approximately \$23,800,000 at December 31, 1999. Of the December 31, 2000 backlog, approximately \$7,600,000 represented orders from foreign telephone operating companies. We expect to ship substantially all of our December 31, 2000 backlog during 2001.

### Intellectual Property Rights

We own a number of domestic utility and design patents and have pending patent applications for these products. In addition, we have foreign patent protection for a number of our products.

From time to time we enter into licensing and technical information agreements under which we receive or grant rights to produce certain subcomponents used in our products. These agreements are for varying terms and provide for the payment or receipt of royalties or technical license fees.

While we consider patent protection important to the development of our business, we believe that our success depends primarily upon our engineering, manufacturing and marketing skills. Accordingly, we do not believe that a denial of any of our pending patent applications, expiration of any of our patents, a determination that any of the patents which have been granted to us are invalid or the cancellation of any of our existing license agreements would have a material adverse effect on our business.

#### Competition

The telephone equipment market in which we do business is characterized by intense competition, rapid technological change and a movement to private ownership of telecommunications networks. In competing for telephone operating company business, the purchase price of equipment and associated operating expenses have become significant factors, along with product design and long-standing equipment supply relationships. In the customer premises equipment market, we are functioning in a market characterized by distributors and installers of equipment and by price competition.

We compete directly with a number of large and small telephone equipment manufacturers in the United States, with Lucent Technologies continuing to be our principal United States competitor. Lucent's greater resources, extensive research and development facilities, long-standing equipment supply relationships with the operating companies of the regional holding companies and history of manufacturing and marketing products similar in function to those produced by us continue to be significant factors in our competitive environment.

Currently, Lucent and a number of companies with greater financial resources than us produce, or have the design and manufacturing capabilities to produce, products competitive with our products. In meeting this competition, we rely primarily on the engineered performance and design characteristics of our products to comparable performance or design, and endeavors to offer our products at prices and with warranties that will make our products compete world wide.

In connection with overseas sales of our line connecting/protecting equipment, we have met with significant competition from United States and foreign manufacturers of comparable equipment and we expect this competition to continue. In addition to Lucent, a number of our overseas competitors have significantly greater resources than we do.

We compete directly with a limited number of substantial domestic and international companies with respect to our sales of OSS systems. In meeting this competition, we rely primarily on the features of our line testing equipment, our ability to customize systems and endeavor to offer such equipment at prices and with warranties that make them competitive.

In addition to the quality and price of the products being offered, the financial stability of a supplier, especially for OSS contracts, is a crucial element. Because these contracts require the supplier to spend considerable funds before the project is completed and require ongoing maintenance service, potential customers consider the financial stability of the supplier as a major consideration in awarding a contract. Our financial position, combined with our recent losses, our working capital deficiency and the scheduled expiration of our financing agreement with our senior lender, may place us at a competitive disadvantage in seeking new business and new orders for existing customers.

#### Research and Development Activities

Porta spent approximately \$5,800,000 in 2000, \$6,100,000 in 1999, and \$6,500,000 in 1998 on its research and development activities. All research and development was company sponsored and is expensed as incurred.

#### Employees

As of February 24, 2001, we had 419 employees of which 79 were employed in

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the United States, 253 in Mexico, 45 in the United Kingdom, 5 in Poland, 3 in Chile, 3 in China, and 31 in Korea (in connection with our Korean joint venture). We believe that our relations with our employees are good, and we have never experienced a work stoppage. Our employees are not covered by collective bargaining agreements, except for our hourly employees in Mexico who are covered by a collective bargaining agreement that expires on December 31, 2002.

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### Executive Officers

Name and Position -----	Age ---
William V. Carney Chairman of the Board and Chief Executive Officer	63
Michael A. Tancredi Senior Vice President, and Secretary and Treasurer	71
Edward B. Kornfeld Senior Vice President -- Operations and Chief Financial Officer	57
Prem G. Chandran Senior Vice President	48
David Rawlings Senior Vice President	57

All of Porta's officers serve at the pleasure of the board of directors. Messrs. Carney and Tancredi are also members of the board of directors. There is no family relationship between any of the executive officers listed above.

Mr. Carney was elected as Chairman of the Board of Directors and Chief Executive Officer in 1996 and has served as a director since 1970. Previously, Mr. Carney had served as Secretary from 1970 to 1996, Senior Vice President from 1989 to 1996 and Chief Technical Officer from 1990 to 1996. He was elected Vice Chairman in January 1988. He was Senior Vice President-Mechanical Engineering from January 1988 to November 1989 and was Senior Vice President-Manufacturing from March 1984 to February 1985, Senior Vice President-Operations from June 1977 to February 1984 and Vice President from 1970 to June 1977.

Mr. Tancredi was elected Senior Vice President and Secretary in 1996. He has been Treasurer since April 1978 and Director since 1970. He had served as Vice President between March 1984 to October of 1996. He was Vice President from April 1978 to February 1984 and Comptroller from April 1971 to March 1978.

Mr. Kornfeld was elected a Senior Vice President-Operations in 1996. He has served as Vice President-Finance and Chief Financial Officer of the Company since October 1995. For more than five years prior to his election to this position, Mr. Kornfeld held positions with several technology companies, including Excel Technology Inc. (Quantronix Corp.) and Anorad Corporation.

Mr. Chandran was elected Senior Vice President in May 1999. Prior to his appointment as Senior Vice President, Mr. Chandran was Vice President since December 1995 and Assistant Vice President of Engineering from 1991 until December 1995.

Mr. Rawlings was elected Senior Vice President in May 1999. Prior to his appointment as Senior Vice President, Mr. Rawlings was Vice President since

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March 1996 and Assistant Vice President of Research and Development - Copper products since from 1992 until March 1996.

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### Item 2. Properties

We currently lease approximately 20,400 square feet of executive, sales, marketing and research and development space in Syosset, New York; and 7,000 square feet of office space used for software development located in Charlotte, North Carolina. We also own a 31,000 square foot manufacturing and research and development facility located in Glen Cove, New York. These facilities represent substantially all of our office, plant and warehouse space in the United States. The Syosset, New York lease expires December 2005, and the Charlotte, North Carolina lease expires in November 2004. The aggregate annual rental is approximately \$435,000.

Our wholly-owned United Kingdom subsidiary leases approximately 34,300 square foot facility in Coventry, England, which facility comprises all of our office, plant and warehouse space. The lease expires in 2019. The aggregate annual rental is approximately \$225,000.

Our wholly-owned Mexican subsidiary owns an approximately 40,000 square foot manufacturing facility in Matamoros, Mexico.

In March 2001, we entered into a contract to sell our Glen Cove, New York facility for \$1,850,000. All personnel will be relocated to other locations.

We believe our properties are adequate for our needs.

### Item 3. Legal Proceedings

In March 2000, we suspended (with pay) Messrs. Ronald Wilkins and Michael Bahlo, two of our executive officers, from their positions pending completion of our investigation of certain matters that had come to our attention. Prior to the completion of this investigation, however, these two executives accepted positions with another company and thereby voluntarily resigned from their positions with us. In February 2001, these two executives, together with a third former executive officer, Mr. Michael Lamb, who similarly resigned from his position with us, filed suit in the Supreme Court for the State of New York, County of New York, entitled Ronald Wilkins, Michael Bahlo and Michael Lamb v. Porta Systems Corp., Index No 600677/01. The complaint asserts various claims against us based on the allegation that each of these three executives was improperly terminated from his employment without cause, and seeks compensatory damages, liquidating damages and attorney's fees. The Company believes that it has valid defenses to the claims and intends to defend this action vigorously and to assert counterclaims against these former executives.

In September 2000, we and BMS Corporation each disputed the performance by the other party of its obligation under certain settlement agreements which were entered into in June 2000. BMS commenced an arbitration proceeding which was settled in January 2001 with the execution of amended agreements. The amended agreement included, among other things, an extended payment schedule, with each such payment being secured by our confession of judgment held in escrow by BMS.

In July 1996, an action was commenced against Porta and certain present and former directors in the Supreme Court of the State of New York, New York County by certain stockholders and warrant holders of Porta who acquired their securities in connection with the acquisition by Porta of Aster Corporation. The complaint alleges breach of contract against Porta and breach of fiduciary duty

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against the directors arising out of an alleged failure to register certain restricted shares and warrants owned by the plaintiffs. The complaint seeks damages of \$413,000; however, counsel for the plaintiff has advised Porta that additional plaintiffs may be added and, as a result, the amount of damages claimed may be substantially greater than the amount presently claimed. Porta believes that the defendants have valid defenses to the claims. Discovery is proceeding, although there has been no significant activity in this matter subsequent to December 31, 1999.

### Item 4. Submission of Matters to a Vote of Securities Holders

During the fourth quarter of 2000, there were no matters required to be submitted to a vote of security holders of the Company.

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## Part II

### Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Our common stock is traded on the American Stock Exchange, Inc. under the symbol PSI. The following table sets forth, for 1999 and 2000, the quarterly high and low sales prices for our common stock on the consolidated transaction reporting systems for American Stock Exchange listed issues.

		High ----	Low ---
1999	First Quarter	\$2.50	\$1.75
	Second Quarter	2.19	1.50
	Third Quarter	1.88	0.63
	Fourth Quarter	1.25	0.63
2000	First Quarter	\$4.88	\$0.81
	Second Quarter	3.63	1.56
	Third Quarter	2.00	0.88
	Fourth Quarter	1.00	0.38

We did not declare or pay any cash dividends in 2000 or 1999. It is our present policy to retain earnings, if any, to finance the growth and development of the business, and therefore, we do not anticipate paying cash dividends on its common stock in the foreseeable future. In addition, Porta's agreement with its senior lender prohibits it from paying cash dividends on its common stock.

As of March 16, 2001, Porta had approximately 983 stockholders of record and the closing price of our common stock was \$0.35.

During 2000, we issued unregistered securities in the following transactions: (i) 100,000 5-year warrants to purchase shares of common stock exercisable at \$2.00 which were subsequently re-priced at an exercise price of \$1.00, (ii) 127,500 3-year warrants to purchase shares of common stock exercisable at \$3.00, and (iii) 15,000 5-year warrants to purchase shares of common stock exercisable at \$1.81. All sales were exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) or 4(6) thereunder or Rule 506 of the Securities and Exchange Commission. No fees were paid to any placement agent or underwriter in connection with any of these sales.

### Item 6. Selected Financial Data

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The following table sets forth certain selected consolidated financial information. All share and per share data have been restated to give effect to the one for five reverse stock split which became effective on August 2, 1996. For further information, see the Consolidated Financial Statements and other information set forth in Item 8 and Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Item 7:

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	Year Ended Decem		
	2000	1999	1998
	(In thousands, except p		
<b>Income Statement Data:</b>			
Sales	\$ 51,140	\$ 38,936	\$ 59,343
Operating income (loss)	(5,153)	(9,709)	4,566
Debt conversion expense	--	--	(945)
Income (loss) before discontinued operations and extraordinary item	(10,176)	(13,686)	451
Net income (loss)	(10,176)	(13,686)	527
<b>Basic per share amounts:</b>			
Continuing operations	\$ (1.04)	\$ (1.44)	\$ 0.05
Net income (loss)	\$ (1.04)	\$ (1.44)	\$ 0.06
<b>Diluted per share amounts:</b>			
Continuing operations	\$ (1.04)	\$ (1.44)	\$ 0.04
Net income (loss)	\$ (1.04)	\$ (1.44)	\$ 0.05
Cash dividends declared	--	--	--
Number of shares used in calculating net income (loss) per share-basic	9,763	9,489	9,281
Number of shares used in calculating net income (loss) per share-diluted	9,763	9,489	9,785
<b>Balance Sheet Data:</b>			
Total assets	\$ 34,174	\$ 43,448	\$ 52,136
Long-term debt excluding current maturities	\$ 376	\$ 21,902	\$ 17,238
Stockholders' equity (deficit)	\$(10,792)	\$ (1,387)	\$ 11,984



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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Our consolidated statements of operations for the three years ended December 31, 2000, 1999 and 1998, respectively, as a percentage of sales is as follows:

	Years Ended December 31,		
	2000	1999	1998
	----	----	----
Sales	100%	100%	100%
Cost of sales	70%	74%	59%
	----	----	----
Gross Profit	30%	26%	41%
Selling, general and administrative expenses	28%	35%	22%
Research and development expenses	12%	16%	11%
	----	----	----
Operating income (loss)	(10%)	(25%)	8%
Interest expense	(9%)	(9%)	(6%)
Other	(1%)	1%	2%
Debt conversion expense	--	--	(2%)
	----	----	----
Income (loss) from continuing operations before income taxes and minority interest	(20%)	(33%)	2%
Income tax expense (benefit) and minority interest	--	2%	1%
	----	----	----
Net income (loss)	(20%)	(35%)	1%
	=====	=====	=====

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Results of Operations

Years Ended December 31, 2000 and 1999

Our sales for 2000 were \$51,140,000 compared to \$38,936,000 in 1999, an increase of \$12,204,000 (31%). The increase in revenue is attributed principally to completion of contracts from our OSS division, although all divisions achieved increased revenues in 2000 as compared to 1999.

OSS sales for 2000 were \$22,296,000, compared to 1999 sales of \$14,254,000, an increase of \$8,042,000 (56%). During 2000, OSS sales resulted primarily from the completion of OSS contracts, which were secured during the latter part of 1999. We expect to complete revenue recognition from these OSS contracts in 2001. Sales of OSS systems are not made on a recurring basis to customers, but are the result of extended negotiations that frequently cover many months and do not always result in a contract. In addition, OSS contracts may include conditions precedent, such as the customer obtaining financing or bank approval, and the contracts are not effective until the conditions are satisfied.

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Line connection/protection equipment sales for 2000 increased approximately \$2,357,000 (13%) from \$18,189,000 in 1999 to \$20,546,000 in 2000. The improved sales level reflected an increase in volume of sales to United States and Mexican customers, which were offset by a decrease in sales to customers in the United Kingdom.

Signal processing revenue for 2000 compared to 1999 increased by \$1,316,000 (21%) from \$6,328,000 to \$7,644,000. The increase in sales primarily reflects accommodations made to customers where requested delays in deliveries in 1999 of orders were shipped during 2000.

Gross margin increased from 26% in 1999 to 30% in 2000. The increase in gross margin is primarily attributed to the higher sales volume in the OSS division. However, the increase in revenue was still not satisfactory in completely eliminating the inefficiency resulting from our inability to absorb our fixed expenses associated with the OSS contracts over our revenue base. This improvement in gross margin was slightly offset by a lower gross margin in connection/protection products in 2000 compared to 1999 due to changes in product mix.

Selling, general and administrative expenses increased by \$970,000 (7%) from \$13,603,000 in 1999 to \$14,573,000 in 2000. The increase from 1999 to 2000 primarily reflects higher than anticipated professional legal expenses due primarily to litigation involving us, particularly litigation and settlement of a dispute with a vendor.

Research and development expenses decreased by \$260,000 (4%) from \$6,090,000 in 1999 to \$5,830,000 in 2000. The decreased expense in 2000 resulted from the completion during 2000 of certain efforts to develop new products primarily related to the OSS business.

As a result of the above, we had an operating loss of \$5,153,000 in 2000 versus operating loss of \$9,709,000 in 1999. The reduced operating loss for 2000 reflects continued profitability in our line connection/protection equipment and signal processing divisions, and a reduction of the operating loss in our OSS division from \$10,650,000 in 1999 to \$6,201,000 in 2000.

Interest expense for 2000 increased by \$929,000 from \$3,571,000 for 1999 to \$4,500,000 in 2000. This change is attributable primarily to increased levels of borrowing from the Company's senior lender and non cash interest expense associated with the issuance and re-pricing of warrants held by the senior lender and subordinated note holders (See Notes to Financial Statements 6 and 8).

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### Results of Operations (continued)

During 2000, we requested the early termination of our obligations to a number of current and former executive officers regarding the funding of split dollar life insurance policies in order to obtain approximately \$1,200,000 of premiums paid by us into the policies. Due to the early termination, we agreed to forfeit approximately \$600,000 of premiums and terminate our interest in the policies which amount was charged to other expenses during 2000.

As the result of the foregoing, the 2000 net loss was \$10,176,000, \$1.04 per share (basic and diluted), compared with a net loss of \$13,686,000, \$1.44 per share (basic and diluted) for 1999.

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Years Ended December 31, 1999 and 1998

Our sales for 1999 were \$38,936,000 compared to \$59,343,000 in 1998, a decrease of \$20,407,000 (34%). The decrease in revenue is attributed principally to shortfalls from our OSS division, although all divisions sustained decreased revenues in 1999 as compared to 1998.

OSS sales for 1999 were \$14,254,000, compared to 1998 sales of \$27,318,000, a decrease of \$13,064,000 (47%). Sales of OSS systems are not made on a recurring basis to customers, but are the result of extended negotiations that frequently cover many months and do not always result in a contract. In addition, OSS contracts may include conditions precedent, such as obtaining financing or bank approval, and the contracts are not effective until the conditions are satisfied. During 1999, OSS sales resulted primarily from the completion of OSS contracts, which were in effect at the beginning of the year. Our major new OSS contracts were signed during the fourth quarter of 1999, and had no effect on our revenue for 1999. These new contracts, which total \$17,000,000 are with the Philippines Long Distance Telephone Co. for approximately \$5,000,000, and Fujitsu Telecommunications Europe LTD for approximately \$12,000,000. We recognized substantially all revenue from these new OSS contracts in 2000.

Line connection/protection equipment sales for 1999 decreased approximately \$6,102,000 (25%) from \$24,291,000 in 1998 to \$18,189,000 in 1999. The decline reflected a reduction in volume of sales to United States and Mexican customers, which were not offset by an increase in sales to new customers.

Signal processing revenue for 1999 compared to 1998 decreased by \$1,211,000 (16%) from \$7,539,000 to \$6,328,000. The decrease in sales primarily reflects customer requested delays in deliveries in 1999 of orders which are expected to be shipped during 2000.

Cost of sales for the year ended December 31, 1999, as a percentage of sales compared to 1998, increased from 59% to 74%. The increase in cost of sales and the resulting decline in gross margin is primarily attributed to inefficiency resulting from the inability to absorb fixed expenses associated with the OSS contracts over a substantially lower revenue base.

Selling, general and administrative expenses increased by \$524,000 (4%) from \$13,079,000 in 1998 to \$13,603,000 in 1999. The increase relates primarily to additional accounts receivable reserve requirements on OSS contracts in the Far East of approximately \$1,000,000, offset by reductions in various operating expenses.

Research and development expenses decreased by \$420,000 (6%) from \$6,510,000 in 1998 to \$6,090,000 in 1999. The decreased expense in 1999 resulted from the completion of certain efforts to develop new products primarily related to the OSS business including the MKIII test head during 1999.

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Results of Operations (continued)

As a result of the above, we had an operating loss of \$9,709,000 in 1999 versus operating income of \$4,566,000 in 1998. Although we sustained a decline in sales in all of our product lines, our decreased operating income for 1999, when compared to 1998, was primarily the result of lower levels of revenue from OSS combined with the reduced margin on OSS business and the accounts receivable reserve on OSS contracts.

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Interest expense for 1999 decreased by \$179,000 from \$3,750,000 for 1998 to \$3,571,000 in 1999. The decrease in interest expense is attributable primarily to the completion of non-cash interest expenses associated with the issuance of warrants to our senior lender. This decrease was substantially offset by additional interest on the increased outstanding principal balance and waiver fee for non-compliance of the interest coverage covenant to the senior lender.

Other income for 1998 included approximately \$240,000 from the final settlement of an insolvency procedure involving the purchaser of our Israeli operations, which was sold in 1992, and \$400,000 from the settlement of a lawsuit against a former vendor.

During 1998, we recorded debt conversion expenses of \$945,000 as a result of the exchange of zero coupon notes into common stock. The debt conversion expense represents the difference between the original conversion price per share of \$6.55 and the reduced conversion price per share of \$3.65.

During 1998, we recorded an extraordinary gain from the early extinguishment of its Debentures of \$76,000.

For 1999, we recorded an income tax expense of \$873,000, which includes an \$811,000 increase in deferred tax asset valuation allowance and tax expenses of \$62,000. For 1998, income tax expenses of \$606,000 primarily represents income taxes payable by our UK and Chilean subsidiaries.

As the result of the foregoing, the 1999 net loss was \$13,686,000, \$1.44 per share basic and diluted, compared with net income of \$527,000, \$0.06 per share basic and \$0.05 per share diluted, for 1998.

### Liquidity and Capital Resources

At December 31, 2000 we had cash and cash equivalents of \$2,366,000 compared with \$3,245,000 at December 31, 1999. Our working capital deficit was \$24,152,000 at December 31, 2000 compared to working capital of \$6,135,000 at December 31, 1999. The decline in working capital was primarily a result of the classification of our senior debt and subordinated debt from long-term to current liabilities. During 2000, we used \$2,901,000 of cash to support our operations. Our principal source of funds during 2000 was borrowings from our senior lender.

We had senior debt outstanding of \$20,746,000 as of December 31, 2000 of which \$150,000 was a non-interest bearing note, \$10,160,000 was outstanding against the revolving line of credit, and \$10,436,000 was a term loan agreement. The agreement requires a quarterly loan amortization of \$400,000. Porta had a revolving line of credit and a letter of credit facility of \$11,000,000 as of December 31, 2000 which decreased to \$9,000,000 on January 2, 2001. During 2000, we borrowed \$5,010,000 and repaid \$1,782,000 to the senior secured lender, of which \$182,000 was provided from the proceeds of the sale of our UK facility.

Our loan and security agreement with our senior secured lender expires July 3, 2001. Pursuant to this agreement, \$1,160,000 of the revolving line of credit matured on January 2, 2001.

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### Liquidity and Capital Resources (continued)

On January 2, 2001, we did not have the resources to make the \$1,160,000

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payment. On March 13, 2001, our senior lender agreed to allow us to defer the repayment of borrowings related to the increased maximum, defer all monthly facility fees and the April 1, 2001 principal payment of \$400,000 until the earlier of the termination of the agreement on July 3, 2001 or the sale by us of one or more of our divisions. The senior lender, as a condition to the above, prohibited us from making any payments on indebtedness to any subordinated creditors except to pay accounts payable in the ordinary course of business.

In addition, we were not in compliance with the interest coverage covenant and borrowing base coverage under the agreement and obtained a waiver from our senior lender through July 2, 2001.

As of December 31, 2000, we had remaining outstanding \$376,000 of 6% Debentures, net of original issue discount of \$9,000, which mature July 2, 2002. The face amount of the outstanding 6% Debentures was \$385,000. The interest accrued on the 6% Debentures is payable on July 1 of each year and as of December 31, 2000 was \$12,000. At December 31, 2000, we were current on our interest obligations.

As of December 31, 2000, we had outstanding \$6,144,000 of subordinated notes. As a result of an agreement with the holders of 85% of these notes, the maturity date of the notes was extended to July 3, 2001. As a result, notes in the principal amount of \$900,000 were due January 3, 2001 and notes in the principal amount of \$5,244,000 become due July 3, 2001. We did not have the resources to pay the \$900,000 of subordinated debt on January 2, 2001 and approximately \$440,000 of interest which was due on January 2, 2001. We are engaged in preliminary discussions with the holders of certain subordinated notes with respect to the possible extension of the notes or the exchange of the notes for equity in Porta.

Our cash availability during 2001 and thereafter may be affected by a number of factors. At December 31, 2000, we had no cash available under our credit facility and we had borrowed more than the amount available to us under our borrowing base. To the extent that credit is not available, we may have difficulty performing our obligations under our contracts, which could result in the cancellation of contracts or the loss of future business. In addition, \$1,160,000 of senior debt and \$900,000 of subordinated debt became due in January 2001 and \$24,830,000 of senior and subordinated debt will become due in July 2001. Under the default provisions of the loan agreement with our senior lender, a default on the subordinated notes can trigger a default in our obligations to the senior lender. We do not presently have the ability to pay these debts and, if we cannot obtain either an extension on the maturity of the debts or an alternative financing source or raise funds from the sale of one of our divisions, we may be unable to meet these financial obligations. We are continuing to negotiate with our senior lender with respect to an extension beyond the July 3, 2001 maturity of our current facility.

We are seeking to address our need for liquidity by seeking to extend our agreement with our senior lender, negotiate an agreement with the holders of the subordinated debt which would result in a deferral of our payment obligations or a conversion of the debt to equity or a combination, and a sale of one or more of our divisions. Although we have been engaged in negotiations with respect to the sale of one of our divisions, these negotiations were terminated without our entering into any agreement. Although we are continuing to explore the possible sale of one or more of our divisions, we cannot assure you that we will be successful in these efforts. Because of our present stock price, it is highly unlikely that we will be able to raise funds through the sales of our equity securities, and our financial condition prevents us from issuing debt securities. In the event that we are unable to extend our debt obligations and sell one or more of our divisions, we cannot assure you that we will be able to continue in operations. In addition, our auditors included in their report an explanatory paragraph about our ability to continue as a going concern.

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Item 7A. Quantitative and Qualitative Disclosure About Market Risk.

Although we conduct operations outside of the United States, most of our contracts and sales are dollar denominated. A portion of the revenue from our United Kingdom operations and the majority of our United Kingdom expenses are denominated in Sterling. Any Sterling-denominated receipts are promptly converted into United States dollars. We do not engage in any hedging or other currency transactions. For 2000, the currency translation adjustment was not significant in relation to our total revenue.

Item 8. Financial Statements and Supplementary Data.

See Exhibit I

Item 9. Changes In and Disagreements With Accountants On Accounting and Financial Disclosure.

Not Applicable

## Part III

Item 10, 11, 12, and 13.

The information called for by Item 10 (Directors and Executive Officers), Item 11 (Executive Compensation), Item 12 (Security Ownership of Certain Beneficial Owners and Management), and Item 13 (Certain Relationships and Related Transactions) is incorporated herein by reference from the Company's definitive proxy statement for the Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission not later than 120 days after the close of the year ended December 31, 2000.

## Part IV

Item 14. Exhibits, Financial Statements Schedules and Reports on Form 8-K.

(a) Document filed as part of this Annual Report on Form 10-K:

(i) Financial Statements.

See Index to Consolidated Financial Statements under Item 8 hereof.

(ii) Financial Statement Schedules.

None

Schedules not listed above have been omitted for the reasons that they were inapplicable or not required or the information is given elsewhere in the financial statements.

Separate financial statements of the registrant have been omitted since restricted net assets of the consolidated subsidiaries do not exceed 25% of consolidated net assets.

(b) Reports on Form 8-K

None.

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### (c) Exhibits

Exhibit No.	Description of Exhibit
-----	-----
3.1	Certificate of Incorporation of the Company, as amended to date, incorporated by reference to Exhibit 4 (a) of the Company's Annual Report on Form 10-K for the year ended December 31, 1991.
3.2	Certificate of Designation of Series B Participating Convertible Preferred Stock, incorporated by reference to Exhibit 3.2 of the Company's Annual Report on Form 10-K for the year ended December 31, 1995.
3.3	By-laws of the Company, as amended to date, incorporated by reference to Exhibit 3.3 of the Company's Annual Report on Form 10-K for the year ended December 31, 1995.
4.1	Amendment dated as of December 16, 1993 to the Warrant Agreement among the Company, Aster Corporation and Chemical Bank as successor to Manufacturers Hanover Trust Company as Warrant Agent, incorporated by reference to Exhibit 4.2 of the Company's Annual Report on Form 10-K for the year ended December 31, 1993.
4.2	Form of Rights Amendments, dated as of March 22, 1989 between the Company and Manufacturers Hanover Trust Company, as Rights Agent, incorporated by reference to the Company's Registration Statement on Form 8-A dated April 3, 1989.
4.3	Amendment No. 1 to Rights Agreement, dated July 28, 1993 between the Company and The Chase Manhattan Bank (formerly known as Chemical Bank, as successor by merger to Manufacturers Hanover Trust Company) as Rights Agent, incorporated by reference to the Company's Registration Statement on Form 8-A/A filed August 4, 1993.
4.4	Amendment No. 2 to Rights Agreement, dated December 24, 1997 between the Company and The Chase Manhattan Bank (formerly known as Chemical Bank, as successor by merger to Manufacturers Hanover Trust Company) as Rights Agent, incorporated by reference to Exhibit 4.2.2 of the Company's Annual Report on Form 10-K for the year ended December 31, 1997.
4.5	Amended and Restated Loan and Security Agreement dated as of November 28, 1994, between the Company and Foothill Capital Corporation, incorporated by reference to Exhibit 2 to the Company's Current Report on Form 8-K dated November 30, 1994.
4.6	Amendment Number One dated February 13, 1995 to the Amended and Restated Loan and Security Agreement dated as of November 28, 1994 between the Company and Foothill Capital Corporation, incorporated by reference to Exhibit 4.7 of the Company's Annual Report on Form 10K for the year ended December 31, 1995.

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- 4.7 Amendment Number Two dated March 30, 1995 to the Amended and Restated Loan and Security Agreement dated as of November 28, 1994 between the Company and Foothill Capital Corporation, incorporated by reference to Exhibit 4.7.2 of the Company's Annual Report on Form 10K for the year ended December 31, 1995.

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### Exhibits (continued)

Exhibit No.	Description of Exhibit
-----	-----
4.8	Amended and Restated Secured Promissory Note dated February 13, 1995, incorporated by reference to Exhibit 4.9 of the Company's Annual Report on Form 10K for the year ended December 31, 1995.
4.9	Deferred Funding Fee Note dated November 28, 1994 made by the Company in favor of Foothill Capital Corporation, incorporated by reference to Exhibit 5 to the Company's Current Report on Form 8-K dated November 30, 1994.
4.10	Amendment Number Three to Amended and Restated Loan and Security Agreement dated March 12, 1996, between the Company and Foothill Capital Corporation, incorporated by reference to Exhibit 4.11 of the Company's Annual Report on Form 10K for the year ended December 31, 1995.
4.11	Warrant to Purchase Common Stock of the Company dated November 28, 1994 executed by the Company in favor of Foothill Capital Corporation, incorporated by reference to Exhibit 6 to the Company's Current Report on Form 8-K dated November 30, 1994.
4.12	Lockbox Operating Procedural Agreement dated as of November 28, 1994 among Chemical Bank, the Company and Foothill Capital Corporation, incorporated by reference to Exhibit 7 to the Company's Current Report on Form 8-K dated November 30, 1994.
4.13	Amendment No. Five dated as of November 30, 1997, to Amended and Restated Loan and Security agreement between Foothill Capital Corp. ("Foothill") and the Company, including amendments to the warrants held by Foothill, incorporated by reference to Exhibit 4.23 of the Company's Form 8-K dated January 2, 1998.
4.14	Amendment No. Six dated as of August 1, 1998 to Amended and Restated Loan and Security agreement between Foothill Capital Corp. ("Foothill") and the Company, incorporated by reference to Exhibit 4.24 of the Company's Annual Report on Form 10-K for the year ended December 31, 1998.
4.15	Amendment No. Seven dated as of December 1, 1998 to Amended and Restated Loan and Security agreement between Foothill Capital Corp. ("Foothill") and the Company, incorporated by reference to Exhibit 4.25 of the Company's Annual Report on Form 10-K for the year ended December 31, 1998.



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- 4.16 Amendment No. Eight dated as of April 10, 2000 to Amended and Restated Loan and Security agreement between Foothill Capital Corp. ("Foothill") and the Company.
- 4.17 Amendment No. Nine dated as of June 9, 2000 to Amended and Restated Loan and Security agreement between Foothill Capital Corp. ("Foothill") and the Company.
- 4.18 Amendment No. Ten dated as of March 1, 2001 to Amended and Restated Loan and Security agreement between Foothill Capital Corp. ("Foothill") and the Company.

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### Exhibits (continued)

Exhibit No.	Description of Exhibit
-----	-----
10.1	Form of Executive Salary Continuation Agreement, incorporated by reference to Exhibit 19 (cc) of the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985.
10.2	Agreement dated May 25, 1988 between British Telecommunications plc and the Company, incorporated by reference to Exhibit 19 (a) of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988. Confidential Treatment granted; document filed separately with the SEC.
10.3	Amendment to agreement of May 25, 1988, dated September 1, 1996, between British Telecommunications plc and the Company, incorporated by reference to Exhibit 10.6.1 of the Company's Annual Report on Form 10-K for the year ended December 31, 1996.
10.4	Lease dated December 17, 1990 between the Company and LBA properties, Inc., incorporated by reference to Exhibit 10 (d) of the Company's annual report on Form 10-K for the year ended December 31, 1990.
10.5	Employee Stock Bonus Program filed as Exhibit 4.3 to the Form S-8 dated February 12, 1999 and incorporated herein by reference.
10.6	1999 Stock Option Plan filed as Exhibit A to the Proxy Statement for the 1999 Annual Meeting to Stockholders and incorporated herein by reference.
10.7	1996 Stock Option Plan filed as Exhibit A to the Proxy Statement for the 1996 Annual Meeting to Stockholders and incorporated herein by reference.
10.8	1998 Stock Option Plan filed as Exhibit 4.2 to the Form S-8 dated December 3, 1998 and incorporated herein by reference.
10.9	Senior Officers and Directors Stock Purchase Program filed as Exhibit 4.2 to the Form S-8 dated February 12, 1999 and incorporated herein by reference.
10.10	Employee Stock Purchase Plan filed as Exhibit 4.1 to the Form

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S-8 dated February 12, 1999 and incorporated herein by reference.

- 22 Subsidiaries of the Company, incorporated by reference to Exhibit 22.1 of the Company's Annual Report on Form 10K for the year ended December 31, 1995.
- 23 Consent of Independent Auditors.

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### SIGNATURES

Pursuant to the requirements of Section 13 or 15(b) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PORTA SYSTEMS CORP.

Dated March 29, 2001

By /s/ William V. Carney

-----  
William V. Carney  
Chairman of the Board and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated. Each person whose signature appears below hereby authorizes William V. Carney and Edward B. Kornfeld or either of them acting in the absence of the others, as his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution for him and in his name, place and stead, in any and all capacities to sign any and all amendments to this report, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission.

Signature	Title	Date
----- /s/ William V. Carney ----- William V. Carney	Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer)	March 29, 2001
----- /s/ Edward B. Kornfeld ----- Edward B. Kornfeld	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 29, 2001
----- /s/ Seymour Joffe ----- Seymour Joffe	Director	March 29, 2001
----- /s/ Michael A. Tancredi ----- Michael A. Tancredi	Director	March 29, 2001
----- /s/ Warren H. Esanu ----- Warren H. Esanu	Director	March 29, 2001

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/s/ Herbert H. Feldman	Director	March 29, 2001
-----		
Herbert H. Feldman		
/s/ Stanley Kreitman	Director	March 29, 2001
-----		
Stanley Kreitman		
/s/ Marco Elser	Director	March 29, 2001
-----		
Marco Elser		
/s/ Robert Schreiber	Director	March 29, 2001
-----		
Robert Schreiber		

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Exhibit I

Item 8. Financial Statements and Supplementary Data

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Report of Independent Certified Public Accountants

The Board of Directors and  
Stockholders of Porta Systems Corp.  
Syosset, New York

We have audited the accompanying consolidated balance sheets of Porta Systems Corp. and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations and comprehensive income (loss),

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stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2000. 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Porta Systems Corp. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered substantial losses from operations in 2000 and 1999 and, as of December 31, 2000, has a stockholders' deficit of \$10,792,000, and has a working capital deficit of \$24,152,000, resulting primarily from approximately \$27 million of debt maturing in July 2001. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ BDO SEIDMAN, LLP  
BDO SEIDMAN, LLP

Melville, New York  
March 21, 2001

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Consolidated Balance Sheets  
December 31, 2000 and 1999  
(in thousands, except par value)

	2000 -----	1999 -----
Assets -----		
Current assets:		
Cash and cash equivalents	\$ 2,366	3,245
Accounts receivable -- trade, less allowance for doubtful accounts of \$2,477 in 2000 and \$1,879 in 1999	7,425	12,137
Inventories	7,150	8,893
Prepaid expenses and other current assets	1,130	1,373
	-----	-----
Total current assets	18,071	25,648

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Property, plant and equipment, net	4,555	4,193
Goodwill, net of amortization of \$5,003 in 2000 and \$4,284 in 1999	10,357	11,076
Other assets	1,191	2,531
	-----	-----
Total assets	\$ 34,174	43,448
	=====	=====
Liabilities and Stockholders' Deficit		
-----		
Current liabilities:		
Current portion of senior debt	\$ 20,746	2,000
Current portion of subordinated notes	6,144	--
Accounts payable	7,173	8,831
Accrued expenses	5,385	5,723
Accrued interest payable	766	588
Accrued commissions	1,553	1,864
Accrued deferred compensation	196	196
Income taxes payable	259	267
Short-term loans	1	44
	-----	-----
Total current liabilities	42,223	19,513
	-----	-----
Senior debt net of current maturities	--	15,518
Subordinated notes	--	6,013
6% Convertible subordinated debentures	376	371
Deferred compensation	987	1,004
Income taxes payable	154	352
Other long-term liabilities	918	971
Minority interest	308	1,093
	-----	-----
Total long-term liabilities	2,743	25,322
	-----	-----
Total liabilities	44,966	44,835
	-----	-----
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, no par value; authorized 1,000,000 shares, none issued	--	--
Common stock, par value \$.01; authorized 20,000,000 shares, issued 9,817,165 and 9,638,861 shares in 2000 and 1999, respectively	98	96
Additional paid-in capital	75,980	75,310
Accumulated deficit	(81,135)	(70,959)
Accumulated other comprehensive loss:		
Foreign currency translation adjustment	(3,797)	(3,896)
	-----	-----
	(8,854)	551
Treasury stock, at cost, 30,940 shares	(1,938)	(1,938)
	-----	-----
Total stockholders' deficit	(10,792)	(1,387)
	-----	-----
Total liabilities and stockholders' deficit	\$ 34,174	43,448

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See accompanying notes to consolidated financial statements.

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
 Consolidated Statements of Operations and Comprehensive Income (Loss)  
 Years ended December 31, 2000, 1999 and 1998  
 (in thousands, except per share amounts)

	2000
	-----
Sales	\$ 51,140
Cost of sales	35,890
	-----
Gross profit	15,250
	-----
Selling, general and administrative expenses	14,573
Research and development expenses	5,830
	-----
Total expenses	20,403
	-----
Operating income (loss)	(5,153)
Interest expense	(4,500)
Interest income	129
Other income (expense), net	(813)
Debt conversion expense	--
	-----
Income (loss) before income taxes and minority interest	(10,337)
Income tax expense	227
Minority interest	(388)
	-----
Income (loss) before extraordinary item	(10,176)
Extraordinary gain on early extinguishment of debt	--
	-----
Net income (loss)	\$(10,176)
	=====
Other comprehensive income (loss), net of tax:	
Foreign currency translation adjustments	99
	-----
Comprehensive income (loss)	\$(10,077)
	=====

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Basic per share amounts:

Income (loss) before extraordinary item	\$ (1.04)
Extraordinary item	--
	-----
Net income (loss) per share of common stock	\$ (1.04)
	=====

Weighted average shares of common stock outstanding	9,763
	=====

Diluted per share amounts:

Income (loss) before extraordinary item	\$ (1.04)
Extraordinary item	--
	-----
Net income (loss) per share of common stock	\$ (1.04)
	=====

Weighted average shares of common stock outstanding	9,763
	=====

See accompanying notes to consolidated financial statements.

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Consolidated Statements of Stockholders' Equity (Deficit)  
Years ended December 31, 2000, 1999 and 1998  
(In thousands)

	Common Stock		Additional	Accumulated	Retained	
	No. of	Par Value	Paid-in	Other	Earnings	
	Shares	Amount	Capital	Comprehensive	(Accumulated	T
	-----	-----	-----	Income	Deficit)	
	-----	-----	-----	(Loss)	-----	
Balance at December 31, 1997	8,644	\$ 86	\$ 70,926	\$ (4,027)	\$ (57,799)	\$
Net income 1998	--	--	--	--	527	
Common stock issued	841	9	3,702	--	--	
Warrants issued	--	--	630	--	--	
Restructure of receivable for employee stock purchases	--	--	(123)	--	(1)	
Receivable from directors and officers under stock purchase program	--	--	--	--	--	
Foreign currency translation adjustment	--	--	--	273	--	
	-----	-----	-----	-----	-----	
Balance at December 31, 1998	9,485	95	75,135	(3,754)	(57,273)	
Net loss 1999	--	--	--	--	(13,686)	
Common stock issued	154	1	119	--	--	
Warrant re-pricing	--	--	56	--	--	
Collection of receivable from directors and officers under						

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stock purchase program	--	--	--	--	--
Foreign currency translation adjustment	--	--	--	(142)	--
	-----	-----	-----	-----	-----
Balance at December 31, 1999	9,639	96	75,310	(3,896)	(70,959)
Net loss 2000	--	--	--	--	(10,176)
Common stock issued	178	2	174	--	--
Warrants issued or re-priced	--	--	496	--	--
Foreign currency translation adjustment	--	--	--	99	--
	-----	-----	-----	-----	-----
Balance at December 31, 2000	9,817	\$ 98	\$ 75,980	\$ (3,797)	\$ (81,135)
	=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Consolidated Statements of Cash Flows (Note 21)  
Years ended December 31, 2000, 1999 and 1998  
(In thousands)

	2000
	-----
Cash flows from operating activities:	
Net income (loss)	\$(10,176)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:	
Extraordinary gain	--
Non-cash debt conversion expense	--
Non-cash financing expenses	373
Non-cash compensation expense	--
Depreciation and amortization	1,911
Amortization of debt discounts	56
Minority interest	(388)
Changes in operating assets and liabilities:	
Accounts receivable	4,712
Inventories	1,743
Prepaid expenses	243
Other assets	1,427
Accounts payable, accrued expenses and other liabilities	(2,405)
	-----
Net cash used in operating activities	(2,504)
	-----
Cash flows from investing activities:	
Repayment of receivables from stock purchase program	--
Capital expenditures, net	(1,533)
	-----
Net cash used in investing activities	(1,533)
	-----



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Cash flows from financing activities:	
Proceeds from senior debt	5,010
Repayments of senior debt	(1,782)
Proceeds from Subordinated debentures and warrants	80
Repayment of zero coupon senior subordinated convertible notes	--
Proceeds from the exercise of options and warrants	176
Proceeds (repayments) of notes payable/short-term loans	(43)
Net cash provided by (used in) financing activities	3,441
Effect of exchange rate changes on cash	(283)
Increase (decrease) in cash and cash equivalents	(879)
Cash and equivalents - beginning of year	3,245
Cash and equivalents - end of year	\$ 2,366

See accompanying notes to consolidated financial statements.

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements  
December 31, 2000 and 1999

(1) Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation

Porta Systems Corp. ("Porta" or the "Company") designs, manufactures and markets systems for the connection, protection, testing and administration of public and private telecommunications lines and networks. The Company has various patents for copper and software based products and systems that support voice, data, image and video transmission. Porta's principal customers are the U.S. regional telephone operating companies and foreign telephone companies.

The accompanying consolidated financial statements include the accounts of Porta and its majority-owned or controlled subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Revenue Recognition

Revenue, other than from long-term contracts for specialized products, is recognized when a product is shipped. Revenues and earnings relating to long-term contracts for specialized products are recognized on the percentage-of-completion basis primarily measured by the attainment of milestones. Anticipated losses, if any, are recognized in the period in which they are identified.

Concentration of Credit Risk

Financial instruments, which potentially subject Porta to concentrations of credit risk, consist principally of cash and accounts receivable. At times such cash in banks exceeds the FDIC insurance limit.

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As discussed in notes 17 and 22, substantial portions of Porta's sales are to customers in foreign countries. The Company's credit risk with respect to new foreign customers is reduced by obtaining letters of credit for a substantial portion of the contract price, and by monitoring credit exposure related to each customer.

### Cash Equivalents

The Company considers investments with original maturities of three months or less at the time of purchase to be cash equivalents. Cash equivalents consist of commercial paper.

### Inventories

Inventories are stated at the lower of cost (on the average or first-in, first-out methods) or market.

### Property, Plant and Equipment

Property, plant and equipment are carried at cost. Leasehold improvements are amortized over the term of the lease. Depreciation is computed using the straight-line method over the related assets' estimated lives.

(Continued)

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## PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

### Deferred Computer Software

Software costs incurred for specific customer contracts are charged to cost of sales at the time revenues on such contracts are recognized. Software development costs relating to products the Company offers for sale are deferred in accordance with Statement of Financial Accounting Standards (SFAS) No. 86 "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed". These costs are amortized to cost of sales over the periods that the related product will be sold, up to a maximum of four years. Amortization of computer software costs, which all relate to products the Company offers for sale, amounted to approximately \$0, \$82,000, and \$461,000 in 2000, 1999 and 1998, respectively.

### Goodwill

Goodwill represents the difference between the purchase price and the fair market value of net assets acquired in business combinations treated as purchases. Goodwill is amortized on a straight-line basis over a remaining life of 10 to 30 years. During 1999 and 2000, in view of recent competitive developments in the telecommunications market place and Porta's changing business model in response, management has reassessed the useful life of certain of its goodwill. While in management's opinion, there is currently no impairment in the carrying value of this long-lived intangible asset (based upon an analysis of undiscounted future cash flows), management has determined that the useful life of the goodwill should be shortened to be more reflective of the current rate of technology change and

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competitive conditions. Accordingly, management changed the estimated useful life of certain goodwill from an original life of 40 years to a remaining life of 13 years in 1999 and 10 years in 2000, which changes were applied prospectively from the fourth quarters of 1999 and 2000. These changes in accounting estimates increased amortization expense in 2000 and in 1999 by approximately \$25,000 and \$58,000, respectively. At December 31, 2000, \$6,465,000 of the goodwill is being amortized over a remaining life of approximately 10 years and \$3,892,000 is being amortized over a remaining life of approximately 30 years. The Company assesses the recoverability of unamortized goodwill using the undiscounted projected future cash flows from the related businesses.

### Income Taxes

Deferred income taxes are recognized based on the differences between the tax bases of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years. Further, the effects of tax law or rate changes are included in income as part of deferred tax expense or benefit for the period that includes the enactment date (note 14).

### Foreign Currency Translation

Assets and liabilities of foreign subsidiaries are translated at year-end rates of exchange, and revenues and expenses are translated at the average rates of exchange for the year. Gains and losses resulting from translation are accumulated in a separate component of stockholders' equity. Gains and losses resulting from foreign currency transactions (transactions denominated in a currency other than the functional currency) are included in comprehensive income or loss.

(Continued)

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## PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

### Net Income (Loss) Per Share

Basic net income (loss) per share is based on the weighted average number of shares outstanding. Diluted net income (loss) per share is based on the weighted average number of shares outstanding plus dilutive potential shares of common stock, if such shares had been issued. The calculation of the diluted net income per share for the year ended December 31, 1998, assumes the exercise of dilutive options and warrants and the conversion of the 6% Subordinated Debentures. For 2000 and 1999, no dilutive potential shares of common stock were added to compute diluted loss per share because the effect was anti-dilutive.

### Reclassifications

Certain reclassifications have been made to conform prior years' consolidated financial statements to the 2000 presentation.

### Accounting for Stock-Based Compensation

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The Company follows the Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation". Porta has elected not to implement the fair value based accounting method for employee stock options, but has elected to disclose the pro-forma net income and earnings per share as if such method had been used to account for stock-based compensation cost as described in the Statement.

### Accounting for the Impairment of Long-Lived Assets

The Company follows the Statement of Financial Accounting Standard No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". Porta believes that there is no impairment of its long-lived assets.

### Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect 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. Among the more significant estimates included in these consolidated financial statements are the estimated allowance for doubtful accounts receivable, inventory reserves, percentage of completion for long-term contracts, and the deferred tax asset valuation allowance. Actual results could differ from those and other estimates.

### New Accounting Standard

Staff Accounting Bulletin (SAB) 101, "Revenue Recognition in Financial Statements", provides guidance on the recognition, presentation and disclosure of revenues in financial statements and requires adoption no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999. The Company implemented SAB 101 and its adoption did not have a material impact on the Company's earnings or financial position.

(Continued)

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## PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

### (2) Liquidity

As of December 31, 2000, Porta's debt includes \$20,746,000 of senior debt of which \$1,160,000 matured on January 2, 2001 and \$19,586,000 matures on July 3, 2001, and \$6,144,000 of subordinated debt of which \$900,000 matured on January 2, 2001 and \$5,244,000 matures on July 3, 2001. Porta did not have the resources to pay the \$1,160,000 due to the senior lender and the \$900,000 due the subordinated debt holders on the January 2, 2001 maturity date. On March 13, 2001, the Company and its senior lender agreed to defer the payment of borrowings due on January 2, 2001, defer all monthly facility fees and the \$400,000 principal payment due on April 1, 2001 to the earlier of the termination of the agreement of July 3, 2001 or the sale of one or more of the divisions of the Company. As part of this agreement, the senior lender precluded the Company from making any

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payments on indebtedness to any subordinated creditors except to pay accounts payable in the ordinary course of business.

The Company was unable to pay the interest payment on the subordinated notes of approximately \$440,000 which was due on January 2, 2001. At December 31, 2000, the Company did not have sufficient resources to pay either the senior lender or the subordinated lenders at maturity and it is likely that it cannot generate such cash from its operations, and the senior lender had precluded us from making payments on the subordinated debt. Although Porta is seeking to refinance or restructure this debt prior to the maturity date, its business may be impaired if it is unable to do so.

The Company's cash availability during 2001 and thereafter may be affected by a number of factors. At December 31, 2000, the Company had no cash available under its credit facility and had borrowed more than the amount available to the Company under its borrowing base. To the extent that credit is not available, the Company may have difficulty performing its obligations under its contracts, which could result in the cancellation of contracts or the loss of future business and penalties for non-performance. In addition, \$1,160,000 of senior debt and \$900,000 of subordinated debt became due in January 2001 and \$24,830,000 of senior and subordinated debt will become due in July 2001. Under the default provisions of the loan agreement with the senior lender, a default on the subordinated notes can trigger a default in the Company's obligations to the senior lender. The Company does not presently have the ability to pay these debts and, if the Company cannot obtain either an extension on the maturity of the debts or an alternative financing source or raise funds from the sale of one or more of its divisions, the Company may be unable to meet these financial obligations.

The Company has been exploring alternatives, including the possible sale of one of its divisions. The Company has been engaged in discussions with respect to the possible sale of one of its divisions. Previous discussions terminated without an agreement. The Company has not signed any agreements with respect to such a sale, and it cannot give any assurance that it will be able to sell any divisions on reasonable terms, if at all. During 2000 and early 2001, the Company has taken

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

steps to reduce overhead and headcount, and consolidate OSS operations. The Company has also entered into an agreement to sell its Glen Cove facility. The Company will continue to look to reduce costs while it seeks additional business from new and existing customers, and pursues an extension of its existing sources of finance or alternative finance sources. The Company has no formal or informal agreement or understanding as to an extension of its existing loans or any alternative financing source, and it cannot give any assurance that it will be able to obtain either an extension of its existing debt or generate funds to enable it to pay its loans.

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These financial statements have been prepared assuming that the Company will continue as a going concern and, accordingly, do not include any adjustments that might result from the outcome of the uncertainties described above.

### (3) Accounts Receivable

Accounts receivable included approximately \$0 and \$3,211,000 at December 31, 2000 and 1999, respectively, of revenues earned but not yet contractually billable relating to long-term contracts for specialized products. All such amounts at December 31, 1999 were billed in 2000. In addition, accounts receivable included approximately \$1,197,000 and \$1,252,000 at December 31, 2000 and 1999, respectively, of retainage balances due on various long-term contracts. All such amounts, net of reserves, at December 31, 2000 are expected to be collected 2001 and all such amounts, net of reserves, at December 31, 1999, were collected in 2000. The allowance for doubtful accounts receivable was \$2,477,000 and \$1,879,000 as of December 31, 2000 and 1999, respectively. The allowance for doubtful accounts was increased by provisions of \$730,000, \$1,070,000, and \$210,000 and decreased by write-offs of \$132,000, \$106,000, and \$353,000 for the years ended December 31, 2000, 1999, and 1998, respectively.

### (4) Inventories

Inventories consist of the following:

	December 31,	
	2000	1999
Parts and components	\$4,973,000	5,558,000
Work-in-process	543,000	584,000
Finished goods	1,634,000	2,751,000
	\$7,150,000	8,893,000
	=====	=====

### (5) Property, Plant and Equipment

Property, plant and equipment consists of the following:

	December 31		
	2000	1999	Estimated useful lives
Land	\$ 246,000	246,000	--
Buildings	2,284,000	2,284,000	20-50 years
Machinery and equipment	8,870,000	9,079,000	3-8 years
Furniture and fixtures	2,700,000	2,825,000	5-10 years
Transportation equipment	133,000	151,000	4 years
Tools and molds	4,124,000	3,474,000	8 years
Leasehold improvements	858,000	871,000	Term of lease
	19,215,000	18,930,000	
Less accumulated depreciation and amortization	14,660,000	14,737,000	
	\$ 4,555,000	4,193,000	
	=====	=====	

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements, Continued

Total depreciation and amortization expense for 2000, 1999 and 1998, related to property, plant and equipment amounted to approximately \$1,156,000, \$998,000 and \$1,197,000, respectively.

In March 2001, Porta entered into a contract to sell its Glen Cove, New York facility for \$1,850,000. It is expected that the transaction will close in June 2001. The carrying value of the land and building at December 31, 2000 was approximately \$1,000,000.

## (6) Senior Debt

On December 31, 2000 and 1999, Porta's long-term debt consisted of senior debt under its credit facility in the amount of \$20,596,000 and \$16,276,000, respectively, and non-interest bearing deferred funding fee notes payable to the senior lender in the amounts of \$150,000 and \$1,242,000, respectively. As of December 31, 2000, the total outstanding principal balance, of which \$1,160,000 was due on January 1, 2001 and \$19,586,000 is due on July 3, 2001, has been classified as a current liability. (See Note 2)

During 2000, the Company and its senior lender agreed to extend the loan and security agreement to July 3, 2001. As part of the agreement, Porta agreed to reduce the exercise price of outstanding warrants to purchase 471,000 shares of common stock held by its senior lender to \$2.00 per share, the value of the reduction of the warrant price was \$169,000 which was recorded as deferred financing expense and additional paid in capital in 2000. In addition during 2000, the Company and its senior lender agreed to increase the revolving line maximum by \$2,000,000 from \$9,000,000 to \$11,000,000 through January 1, 2001. As of December 31, 2000, the Company had borrowed \$1,160,000 under the increased revolving line. As of January 1, 2001 the revolving line maximum will return to \$9,000,000. As consideration, the Company issued to its senior lender a five-year warrant to purchase 100,000 shares of common stock at \$2.00 per share. The value of the warrants issued was \$129,000 which was recorded as deferred financing expense and additional paid in capital in 2000. The balance of the facility is comprised of a term loan. The credit facility is secured by substantially all of Porta's assets. All obligations, except undrawn letters of credit, letter of credit guarantees and the deferred fee notes, bear interest at 12%. The Company incurs a fee of 2% per annum on the average balance of letter of credit guarantees outstanding. In connection with the senior lender's waiver of non-compliance during 2000, the Company reduced from \$2.00 per share to \$1.00 per share, the exercise price of warrants to purchase 571,000 shares of common stock which are held by the lender. The value of the reduction on exercise price was \$59,000 and recorded as deferred financing expense and additional paid in capital. Based upon the warrant transactions during 2000, additional non-cash interest expense of \$289,000 was recognized.

The agreement provides for loan principal payments of \$400,000 on the last day of each quarter during the term of the agreement. As part of the agreement, the loan amortization shall first be applied to

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the non-interest bearing notes payable until these notes are paid in full and then to the term loan. The agreement also requires Porta to pay additional principal payments if its cash flow exceeds certain amounts. A monthly facility fee payment of \$50,000 continuing to the end of the agreement is also required.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

On January 2, 2001, Porta did not have the resources to repay the \$1,160,000 of principal due. In March 2001, the senior lender agreed to allow the Company to defer the repayment of borrowings related to the increased maximum, defer all monthly facility fees and the April 1, 2001 principal payment to the earlier of the termination of the agreement of July 3, 2001 or the sale of one or more of the divisions of the Company. The agreement also precluded the Company from making any payments on indebtedness to any subordinated creditors, although it permits payment of accounts payable in the ordinary course of business.

Financial debt covenants include an interest coverage ratio measured quarterly, limitations on the incurrence of indebtedness, limitations on capital expenditures, and prohibitions on declarations of any cash or stock dividends or the repurchase of the Company's stock. As of December 31, 2000, the Company was not in compliance with the interest coverage covenant. In addition, as of December 31, 2000, the outstanding advances from the senior lender exceeded the maximum allowable under the borrowing base formula since the Company's eligible assets were not sufficient to support the outstanding balance under the combined revolving advance and standby letters of credit guarantee. As a result, the outstanding advances from the senior lender exceeded the maximum allowable under the borrowing base formula by \$3,700,000 as of March 9, 2001. The Company has obtained a waiver of such non-compliance from its senior lender related to the interest coverage ratio and the over advance under the line through July 2, 2001.

Maturities of Porta's long-term debt, including convertible subordinated debentures and subordinated notes (notes 7 and 8), are as follows:

2001	\$26,890,000
2002	376,000
	-----
	\$27,266,000
	=====

#### (7) 6% Convertible Subordinated Debentures and Zero Coupon Senior Subordinated Convertible Notes

As of December 31, 2000 and 1999 Porta had outstanding \$376,000 and \$371,000 of its 6% convertible subordinated debentures due July 1, 2002 (the "Debentures"), net of original issue discount of \$9,000 and \$14,000, respectively. The face amount of the outstanding Debentures was \$385,000 at both December 31, 2000 and 1999. The Debentures are convertible at any time prior to maturity into Common Stock of the Company at a conversion rate of 8.333 shares for each



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\$1,000 face amount of Debentures, subject to adjustment under certain circumstances.

The Debentures are redeemable at the option of Porta, (a) in whole or in part, at redemption prices ranging from 89.626% of face amount beginning July 1, 1995 to 100% of face amount beginning July 1, 2001 and thereafter, together with accrued and unpaid interest to the redemption date, and (b) in whole at any time, at a redemption price equal to the issue price plus interest and that portion of the original issue discount and interest accrued to the redemption date, in the event of certain changes in United States taxation or the imposition of certain certification, information or other reporting requirements.

Interest on the Debentures is payable on July 1 of each year. The interest accrued amounted to \$12,000 as of both December 31, 2000 and 1999.

Pursuant to a debt restructuring prior to and during 1998, the Company recorded an extraordinary gain of approximately \$76,000 in 1998.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

#### (8) Subordinated Notes

As of December 31, 2000 and 1999, \$6,144,000 and \$6,013,000, respectively, of Subordinated Notes were outstanding which includes \$144,000 and \$64,000, respectively, of additional principal from paid in kind options and unamortized debt discount of \$0 and \$51,000, respectively. As of December 31, 2000, \$900,000 matured on January 2, 2001 and \$5,244,000 will mature on July 3, 2001.

Porta did not have the resources to pay the \$900,000 principal and approximately \$440,000 of interest on the subordinated debt which was due on January 2, 2001. In addition, the senior lender had precluded the Company from making payments on the subordinated debt. (See Note 2)

During December 1999, Porta (a) extended its maturity date of the \$6,000,000 outstanding principal amount of Subordinated Notes to January 3, 2001 with the right to extend the maturity date to July 3, 2001 if Porta achieves certain financial results, (b) increased the interest rate of the Subordinated Notes to 14% per annum during the initial term and to 15% during the extended term, (c) reduced the exercise price of the previously issued Series B and C Warrants to \$1.00 per share, (d) granted the holders of the Subordinated Notes the right to a payment in kind option, whereby the note holder has the right to receive interest in the form of a new subordinated note in the principal amount equal to 125% of the interest then due, with the new subordinated note bearing interest at the rate of 125% of the then current interest rate of the Subordinated Notes, and (e) agreed that, if Porta extends the maturity date of the Subordinated Notes to July 3, 2001, it will issue to the noteholders New Warrants to purchase a total of 300,000 shares of Common Stock at the average closing price of the Common Stock for five trading days preceding January 3, 2001. As a result of the amendment to the Subordinated

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Notes, Porta recorded a discount of approximately \$56,000 relating to the re-pricing of the warrants and additional interest expense for Noteholders who elected the paid in kind option at December 31, 1999 of approximately \$13,000.

In April 2000, the Company and the holders of \$5,100,000, or 85%, of the subordinated notes agreed to eliminate the requirement that Porta meet specific financial goals for Porta to extend the maturity date of their subordinated notes to July 3, 2001. In connection with this agreement, Porta agreed to issue to the noteholders New Warrants to purchase 127,500 shares of Common Stock at \$3.00 per share, the value of which was determined to be \$140,000 and recorded as deferred financing expenses and additional paid in capital in 2000. Additional non-cash interest expense of \$84,000 was recorded during 2000 in connection with this transaction. Porta may issue to any other noteholders who agree to this amendment New Warrants to purchase up to 22,500 shares of Common Stock at \$3.00 per share. The remaining New Warrants to purchase 150,000 shares of Common Stock will be issued if the notes are extended.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

#### (9) Joint Venture

The Company has a 50% interest in a joint venture agreement with a Korean partner. Unless otherwise terminated in accordance with the joint venture agreement, the joint venture will terminate on December 31, 2010. In addition, the Company has obtained an option to acquire an additional 1% interest of the joint venture, for approximately \$190,000. The Company consolidates the operations of the joint venture since the Company can obtain a controlling interest at its election and the joint venture is entirely dependent on the Company for the products it sells and receives management assistance from the Company. The joint venture partner's interest is shown as a minority interest.

#### (10) Stockholders' Equity

Porta had outstanding warrants to its senior lender to purchase 571,152 shares of common stock, which are immediately exercisable at \$1.00 per share and for which 471,152 expire on November 30, 2002 and 100,000 expire on June 6, 2005.

Porta had outstanding to an investment banker warrants to purchase 400,000 shares of common stock at \$1.56 per share which expire April 2002.

See Note 8 in connection with the issuance of the Series B and C Warrants as part of the private placement of the subordinated Notes and the amendment of the terms of the Subordinated Notes and Series B and C Warrants.

As of December 31, 2000, Porta had stock purchase warrants outstanding to purchase (i) 53,000 shares of common stock at an exercise price of \$17.50 per share until November 2001 and (ii) 15,000 shares of common stock at an exercise price of \$1.8125 per share until May

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2005 of which warrants to purchase 5,000 shares of common stock are immediately exercisable.

Under a 1984 Employee Incentive Plan, Porta provided an opportunity for certain employees of the Company and its subsidiaries to acquire subordinated convertible debentures. As a result, as of December 31, 1998, there was \$13,000 of employee promissory notes receivable outstanding, of which the maturity date has been extended to April 1999. During 1998, the Board of Directors approved a reduction in the original issue price of the debentures to the then current market rate of the common stock, approximately \$1.38 per share, which common stock was held by Porta as collateral for the notes. Accordingly, the related receivable from employees was reduced from \$307,000 to \$13,000 to reflect the new valuation. The reduction on the original issue resulted in a non-cash compensation charge in 1998 of \$298,000. During 1999, all of the receivables from employees were paid.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

#### (11) Stockholder Rights Plan

Porta has a Stockholder Rights Plan in which preferred stock purchase rights were distributed to stockholders as a dividend at the rate of one right for each common share. Each right entitles the holder to buy from Porta one one-hundredth of a newly issued share of Series A junior participating preferred stock at an exercise price of \$175.00 per right.

The rights will be exercisable only if a person or group acquires beneficial ownership of 22.5 percent or more of Porta's common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 22.5 percent or more of the common stock.

If any person becomes the beneficial owner of 22.5 percent or more of Porta's common stock other than pursuant to an offer for all shares which is fair to and otherwise in the best interests of Porta and its stockholders, each right not owned by such person or related parties will enable its holders to purchase, at the right's then current exercise price, shares of common stock of Porta (or, in certain circumstances as determined by the Board of Directors, a combination of cash, property, common stock or other securities) having a value of twice the right's exercise price. In addition, if Porta is involved in a merger or other business combination transaction with another person in which its shares are changed or converted, or sells more than 50 percent of its assets to another person or persons, each right that has not previously been exercised will entitle its holder to purchase, at the right's then current exercise price, common shares of such other person having a value of twice the right's exercise price.

Porta will generally be entitled to redeem the rights, by action of a majority of the continuing directors of the Company, at \$.01 per right at any time until the tenth business day following public announcement

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that a 22.5 percent position has been acquired.

### (12) Employee Benefit Plans

Porta has deferred compensation agreements with certain officers and employees, with benefits commencing at retirement equal to 50% of the employee's base salary, as defined. Payments under the agreements will be made for a period of fifteen years following the earlier of attainment of age 65 or death. During 2000, 1999 and 1998, Porta accrued approximately \$180,000, \$180,000 and \$185,000, respectively, under these agreements.

In 1986, Porta established the Porta Systems Corp. 401(k) Savings Plan for the benefit of eligible employees, as defined in the Savings Plan. Participants contribute a specified percentage of their base salary up to a maximum of 15%. Porta will match a participant's contribution by an amount equal to 25% of the first 6% contributed by the participant. A participant is 100% vested in the balance to his credit. For the years ended December 31, 2000, 1999 and 1998, Porta's contribution amounted to \$72,000, \$93,000 and \$96,000, respectively.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

In 1999, Porta established the Employee Stock Purchase Plan for the benefit of eligible employees, as defined in the Purchase Plan, which permits employees to purchase Porta's common stock at discounts up to 10%. Porta has reserved 1,000,000 shares of Porta stock for issuance under the plan. During 2000, 84,804 shares were issued pursuant to the Purchase Plan. Subsequent to December 31, 2000, Porta issued approximately 38,900 shares of stock to the participants of the Purchase Plan.

Porta does not provide any other post-retirement benefits to any of its employees.

### (13) Incentive Plans

During 1999, Porta established an Employee Stock Bonus Plan whereby stock may be given to non-officers or directors to recognize the contributions of employees. A maximum of 100,000 shares of common stock is reserved for issuance pursuant to the Bonus Plan. During 1999 Porta issued 4,250 shares of common stock pursuant to the Bonus Plan and recorded a charge of approximately \$8,000. No share of common stock were issued pursuant to the Bonus Plan during 2000.

Porta's 1986 Stock Incentive Plan ("1986 Plan"), expired in March 1996, although options granted prior to the expiration date remain in effect in accordance with their terms. Options granted under the 1986 Plan may be incentive stock options, as defined in the Internal Revenue Code, or options that are not incentive stock options. The exercise price for all options granted were equal to the fair market value at the date of grant.

Porta's 1996 Stock Incentive Plan ("1996 Plan") covers 450,000 shares of

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common stock. Incentive stock options cannot be issued subsequent to ten years from the date the 1996 Plan was approved. Options under the 1996 Plan may be granted to key employees, including officers and directors of the Company and its subsidiaries, except that members and alternate members of the stock option committee are not eligible for options under the 1996 Plan. The exercise price for all options granted were equal to the fair market value at the date of grant and vest as determined by the board of directors. In addition, the 1996 Plan provides for the automatic grant to non-management directors of non-qualified options to purchase 2,000 shares on May 1st of each year commencing May 1, 1996, based upon the average closing price of the last ten trading days of April of each year.

Porta's 1998 Stock Non-Qualified Stock Option Plan ("1998 Plan") covers 450,000 shares of common stock. Options under the 1998 Plan may be granted to key employees, including officers and directors of the Company and its subsidiaries. The exercise price for all options granted were equal to the fair market value at the date of grant and vest as determined by the board of directors.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

Porta's 1999 Incentive and Non-Qualified Stock Option Plan ("1999 Plan") covers 400,000 shares of common stock. Incentive stock options cannot be issued subsequent to ten years from the date the 1999 Plan was approved. Options under the 1999 Plan may be granted to key employees, including officers and directors of the Company and its subsidiaries, except that members and alternate members of the stock option committee are not eligible for options under the 1999 Plan. The exercise price for all options granted were equal to the fair market value at the date of grant and vest as determined by the board of directors. In addition, the 1999 Plan provides for the automatic grant to non-management directors of non-qualified options to purchase 5,000 shares on May 1st of each year commencing May 1, 1999, based upon the average closing price of the last ten trading days of April of each year; provided, however, that the non-management directors will not be granted non-qualified options pursuant to the 1999 Plan for any year to the extent options are granted under the 1996 Plan for such year.

During 1998, pursuant to an employment contract with an officer, Porta issued options to purchase 30,000 shares of common stock at \$1.25 per share, which approximated market value on the date of issuance, and expire on August 2004. As of December 31, 2000, all options to purchase shares of common stock had been forfeited pursuant to the terms of the contract.

During 1999, pursuant to employment contracts with 4 officers, Porta issued options to purchase 95,000 shares of common stock at \$2.06, as to 60,000 shares and \$1.75, as to 35,000 shares. The exercise prices approximated market value on the date of issuance. As of December 31, 2000, 80,000 options to purchase shares of common stock had been forfeited. The remaining 15,000 options expire in May 2005. As of December 31, 2000, 5000 of the options are vested.

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Porta applies APB Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25") and related Interpretations in accounting for the 1999, 1998, 1996 and 1986 Plans. Under APB 25, no compensation cost is recognized for options granted to employees at exercise prices greater than or equal to fair market value of the underlying common stock at the date of grant.

Porta has adopted the disclosure only provisions of Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS No.123") which requires the Company to provide, beginning with 1995 grants, pro forma information regarding net income and net income per common share (basic and diluted) as if compensation costs for Porta's stock option plans had been determined in accordance with the fair value method prescribed in SFAS No.123. If Porta had elected to recognize compensation costs based on fair value of the options granted at grant date as prescribed by SFAS No. 123, net income (loss) and net income (loss) per share (basic and diluted) would have been reduced to the pro forma amounts indicated below:

(Dollars in thousands, except per share data)

	2000 -----	1999 -----	1998 -----
Pro forma net income (loss)	\$(10,393)	\$(14,280)	\$ 237
Pro forma net income (loss) per share (basic and diluted)	\$ (1.06)	\$ (1.50)	\$ 0.03

The weighted-average fair value of options granted was \$1.62, \$ 1.36 and \$1.47 per share in 2000, 1999 and 1998, respectively.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions for 2000, 1999 and 1998:

	2000 ----	1999 ----	1998 ----
Dividends:	\$0.00 per share	\$0.00 per share	\$0.00 per share
Volatility:	57.64%-68.70%	45.80%-80.00%	46.10%-80.00%
Risk-free interest:	5.54%-6.53%	4.50%-6.40%	4.80%-6.40%
Expected term:	5 years	5 years	5 years

A summary of the status of Porta's 1986 stock option plan as of December 31, 2000, 1999, and 1998, and changes during the years ending on those dates is presented below:

2000 -----		1999 -----	
Shares	Weighted	Shares	Weighted

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	Under Option -----	Average Exercise Price -----	Under Option -----	Average Exercise -----
Outstanding beginning of year	3,000	\$ 5	15,527	\$
Granted	--	--	--	
Exercised	--	--	--	
Forfeited	--	--	(12,527)	
	-----	-----	-----	
Outstanding end of year	3,000	\$ 5	3,000	\$
	=====		=====	
Options exercisable at year-end	3,000		3,000	
	=====		=====	

The following table summarizes information about stock options outstanding under the 1986 Plan at December 31, 2000:

Range of Exercise Prices -----	Options Outstanding -----			Options Exercis -----	
	Outstanding at 12/31/00 -----	Remaining Contractual Life -----	Weighted-average Exercise Price -----	Exercisable at 12/31/00 -----	Weigh Exerc -----
\$ 5	3,000 =====	1.8 years	\$ 5	3,000 =====	

A summary of the status of Porta's 1996 stock option plan as of December 31, 2000, 1999 and 1998, and changes during the year is presented below:

	2000 -----		1999 -----	
	Shares Under Option -----	Weighted Average Exercise Price -----	Shares Under Option -----	Weighted Average Exercise -----
Outstanding beginning of year	412,838	\$ 1.73	447,938	\$ 1.
Granted	--	--	--	
Exercised	(6,000)	1.50	--	
Forfeited	(6,075)	1.51	(35,100)	1.
	-----	-----	-----	
Outstanding end of year	400,763	\$ 1.73	412,838	\$ 1.
	=====		=====	
Options exercisable at year-end	400,763		412,838	
	=====		=====	

(Continued)

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The following table summarizes information about stock options outstanding under the 1996 Plan at December 31, 2000:

Range of Exercise Prices	Options Outstanding			Options Exercis	
	Outstanding at 12/31/00	Remaining Contractual Life	Weighted-average Exercise Price	Exercisable at 12/31/00	Weigh Exerc
\$ 1 to 5	400,763 =====	5.5 years	\$ 1.73	400,763 =====	\$

A summary of the status of Porta's 1998 stock option plan as of December 31, 2000, and changes during the year is presented below:

	2000		1999	
	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise
Outstanding beginning of year	429,200	\$3.28	444,500	\$3.2
Granted	--	--	2,200	1.9
Exercised	--	--	--	--
Forfeited	(17,250)	3.25	(17,500)	2.3
Outstanding end of year	411,950 =====	\$3.24	429,200 =====	\$3.2
Options exercisable at year-end	358,850 =====		358,400 =====	

The following table summarizes information about stock options outstanding under the 1998 Plan at December 31, 2000:

Range of Exercise Prices	Options Outstanding			Options Exercis	
	Outstanding at 12/31/00	Remaining Contractual Life	Weighted-average Exercise Price	Exercisable at 12/31/00	Weigh Exerc
\$ 1 to 5	411,950 =====	3.1 years	\$ 3.24	358,850 =====	\$

A summary of the status of Porta's 1999 stock option plan as of December 31, 2000, and changes during the year is presented below:

	2000		1999	
	Shares	Weighted	Shares	Weighted



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	Under Option -----	Average Exercise Price -----	Under Option -----	Average Exercise -----
Outstanding beginning of year	25,500	\$1.72	0	\$0.00
Granted	108,500	3.12	25,500	1.72
Exercised	--	--	--	--
Forfeited	--	--	--	--
	-----		-----	
Outstanding end of year	134,000	\$2.86	25,500	\$1.72
	=====		=====	
Options exercisable at year-end	45,167		25,000	
	=====		=====	

(Continued)

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements, Continued

The following table summarizes information about stock options outstanding under the 1999 Plan at December 31, 2000:

Range of Exercise Prices -----	Options Outstanding			Options Exercisable	
	Outstanding at 12/31/00 -----	Remaining Contractual Life -----	Weighted-average Exercise Price -----	Exercisable at 12/31/00 -----	Weighted-average Exercise Price -----
\$ 1 to 5	134,000 =====	6.4 years	\$ 2.86	45,167 =====	\$

(14) Income Taxes

The provision for income taxes consists of the following:

	2000		1999	
	Current -----	Deferred -----	Current -----	Deferred -----
Federal	\$ --	--	--	716,000
State and foreign	227,000	--	62,000	95,000
	-----	-----	-----	-----
Total	\$227,000 =====	-- =====	62,000 =====	811,000 =====

The domestic and foreign components of income (loss) before provision for income taxes were as follows:

2000 ----	1999 ----	1998 ----
--------------	--------------	--------------

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United States	\$ (7,519,000)	(7,516,000)	(1,424,000)
Foreign	(2,430,000)	(5,297,000)	2,481,000
	-----	-----	-----
Income (loss) before provision for income taxes	\$ (9,949,000)	(12,813,000)	1,057,000
	=====	=====	=====

A reconciliation of Porta's income tax provision and the amount computed by applying the statutory U.S. federal income tax rate of 34% to income (loss) from continuing operations before income taxes is as follows:

	2000
	----
Tax expense (benefit) at statutory rate	\$ (3,383,000)
Increase (decrease) in income tax benefit resulting from:	
Increase (decrease) in valuation allowance	2,776,000
State and foreign taxes, less applicable federal benefits	(127,000)
Debt conversion expense not deductible for tax	--
Other expenses not deductible for tax	345,000
Foreign income taxed at rates	
Different from U.S. statutory rate	25,000
Utilization of net operating loss carryforward	--
Expiration of capital loss and investment tax credit carryforwards	--
Estimated NOL adjustments, including Section 382 limitation	594,000
Other	(3,000)
	-----
	\$ 227,000
	=====

Porta has unused United States tax net operating loss (NOL) carryforwards of approximately \$85,000,000 expiring at various dates between 2009 and 2020. No tax benefit or expense was apportioned to the 1998 extraordinary gains, as such amounts are immaterial. Due to the change in ownership which resulted from the conversion of Porta's Zero coupon subordinated convertible notes to common stock, Porta's usage of its NOL will be limited in accordance with Internal Revenue Code section 382. Porta's carryforward utilization of the NOL is limited to \$1,767,000 per year. The carryforward amounts are subject to review by the Internal Revenue Service (IRS). The capital loss carryforwards expired during 1998 and, as a result of the section 382 limitation, no benefit from tax credit carryforwards will be available. In addition, Porta has foreign NOL carryforwards of approximately \$3,400,000 with indefinite expiration dates.

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements, Continued

Porta's United States net operating loss carryforwards (after limitations as described above) expire in the following years:

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2009	\$ 4,106,000
2010	18,880,000
2011	884,000
2018	37,000
2019	7,546,000
2020	8,761,000
	-----
	\$ 40,214,000
	=====

The components of the deferred tax assets, the net balance of which zero after the valuation allowance, as of December 31, 2000 and 1999 are as follows:

	2000	1999
	----	----
Deferred tax assets:		
Inventory	\$ 1,211,000	1,193,000
Allowance for doubtful accounts receivable	828,000	723,000
Benefits of tax loss carryforwards	16,622,000	13,285,000
Benefit plans	845,000	819,000
Accrued commissions	581,000	718,000
Other	390,000	449,000
Depreciation	392,000	906,000
	-----	-----
	20,869,000	18,093,000
Valuation allowance	(20,869,000)	(18,093,000)
	-----	-----
	\$ --	--
	=====	=====

Deferred taxes result from temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. The temporary differences result from costs required to be capitalized for tax purposes by the US Internal Revenue Code, and certain items accrued for financial reporting purposes in the year incurred but not deductible for tax purposes until paid.

Because of Porta's losses in 2000 and 1999, a valuation allowance for the entire deferred tax asset was provided due to the uncertainty as to future realization.

The income tax returns of Porta and its subsidiary operating in Puerto Rico were examined by the IRS for the tax years ended December 31, 1989 and 1988. As a result of this examination, the IRS increased the Puerto Rico subsidiary's taxable income resulting from intercompany transactions, with a corresponding increase in Porta's net operating losses. The settlement amounted to approximately \$953,000. Porta is currently in a structured settlement with the IRS, which is reviewed annually, whereby monthly payments will be made to liquidate the settlement. Aggregate annual amounts payable by Porta, including interest on the unpaid amounts at a current rate of 7%, is \$240,000 in 2000. As of December 31, 2000, Porta has made all the required payments through that date under the settlement and approximately \$398,000 remains outstanding.

No provision was made for U.S. income taxes on the undistributed earnings of Porta's foreign subsidiaries as it is management's intention to utilize those earnings in the foreign operations for an indefinite period of time or repatriate such earnings only when tax effective to do so. At December 31, 2000, undistributed earnings of the foreign subsidiaries amounted to approximately \$26,000. It is

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not practicable to determine the amount of income or withholding tax that would be payable upon the remittance of those earnings.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

#### (15) Leases

At December 31, 2000, Porta and its subsidiaries leased manufacturing and administrative facilities, equipment and automobiles under a number of operating leases. Porta is required to pay increases in real estate taxes on the facilities in addition to minimum rents. Total rent expense for 2000, 1999, and 1998 amounted to approximately \$876,000, \$874,000 and \$716,000, respectively. Minimum rental commitments, exclusive of future escalation charges, for each of the next five years are as follows:

2001	\$ 1,005,000
2002	866,000
2003	753,000
2004	719,000
2005	558,000
Thereafter	3,215,000
	-----
	\$ 7,116,000
	=====

#### (16) Contingencies

At December 31, 2000, Porta was contingently liable for outstanding letters of credit and surety bonds aggregating approximately \$720,000 and \$3,480,000, respectively, as security for the performance of certain long-term contracts.

Porta is a party to legal actions arising out of the ordinary conduct of its business. Management believes that the settlement of these matters will not have a materially adverse effect on the financial position of the Company (note 20).

#### (17) Major Customers

During the years ended December 31, 2000, 1999 and 1998, Porta's five largest customers accounted for sales of \$28,323,000, or approximately 55% of sales, \$19,700,000, or approximately 51% of sales, and \$28,797,000, or approximately 49% of sales, respectively. Porta's largest customer in 2000 with sales of \$12,051,000, or approximately 24% of sales, was Fujitsu Telecommunications Europe LTD ("FTEL"). A significant amount of sales of our products for use by British Telecommunications plc ("BT") were sold to FTEL as purchasing agent to BT. Porta's largest customer in 1999 and 1998 was BT. Sales to BT for the year ended December 31, 2000, 1999 and 1998 amounted to \$5,098,000, \$7,825,000 and \$15,349,000, respectively, or approximately 10%, 20% and 26%, respectively, of Porta's sales for such years. Therefore, any significant interruption or decline in sales to FTEL or BT may have a materially adverse effect upon Porta's operations. During 2000, sales to a

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Mexican telephone company were \$5,507,000, or approximately 11% of sales. During 1998, sales to a Chilean telephone company were \$6,834,000, or approximately 12% of sales. No other customers account for 10% or more of Porta's sales for any year. Approximately 26% and 28%, respectively, of Porta's accounts receivable are due from the five largest customers as of December 31, 2000 and 1999, respectively.

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

(18) Fair Values of Financial Instruments

Cash equivalents, accounts receivable, accounts and notes payable, and short-term loans are reflected in the consolidated financial statements at fair value because of the short term maturity of these instruments.

The fair value of Porta's long-term debt cannot be reasonably estimated due to the lack of marketability of such instruments.

(19) Net Income (Loss) Per Share

The following table sets forth the computation of basic and diluted net income (loss) per share:

	2000
Numerator-Basic and diluted	
Net income (loss) per share:	
Income (loss) from continuing operations	\$(10,176,000)
Extraordinary item	--
	-----
Net income (loss)	\$(10,176,000)
	=====
Denominator:	
Denominator for basic net income (loss)	
per share -weighted-average shares	9,763,000
Effect of dilutive securities:	
Options and Warrants	--
6% Convertible Subordinated Notes	--
	-----
Denominator for diluted net income (loss) per share-	
adjusted weighted-average shares and	
assumed conversions	9,763,000
	=====
Basic per share amounts:	
Continuing operations	\$ (1.04)
Extraordinary item	--
	-----
Net income (loss) per share	

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of common stock	\$ (1.04)
	=====
Diluted per share amounts:	
Continuing operations	\$ (1.04)
Extraordinary item	--
	-----
Net income (loss) per share of common stock	\$ (1.04)
	=====

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

Options to purchase 649,733, 638,508 and 486,577 shares of common stock for 2000, 1999 and 1998, respectively, with exercise prices ranging from \$1.69 to \$5.00, \$1.69 to \$5.00 and \$3.25 to \$86.25 for 2000, 1999 and 1998, respectively, were outstanding but not included in the computation of diluted net income (loss) per share because the exercise prices were greater than the average market price of common stock during such years.

Warrants to purchase 195,500, 913,000 and 53,000 shares of common stock for 2000, 1999 and 1998, respectively, with exercise prices ranging from \$1.81 to \$17.50, \$1.56 to \$17.50 and \$17.50 for 2000, 1999 and 1998, respectively, were outstanding but not included in the computation of diluted net income (loss) per share because the exercise prices were greater than the average market price of common stock during such years.

#### (20) Legal Matters

In March 2000, the Company suspended (with pay) Messrs. Ronald Wilkins and Michael Bahlo, two of its executive officers, from their positions pending completion of the Company's investigation of certain matters that had come to its attention. Prior to the completion of this investigation, however, these two executives accepted positions with another company and thereby voluntarily resigned from their positions with the Company. In February 2001, these two executives, together with a third former executive officer, Mr. Michael Lamb, who similarly resigned from his position with the Company, filed suit in the Supreme Court for the State of New York, County of New York. The complaint asserts various claims against the Company based on the allegation that each of these three executives was improperly terminated from his employment without cause, and seeks compensatory damages, liquidating damages and attorney's fees. The Company believes that it has valid defenses to the claims and intends to defend this action vigorously and to assert counterclaims against these former executives.

In September 2000, the Company and BMS Corporation each disputed the performance by the other party of its obligations under certain settlement agreements which were entered into in June 2000. BMS commenced an arbitration proceeding which was settled in January 2001 with the execution of amended agreements. The amended agreement included, among other things, an extended payment schedule, with

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each such payment being secured by the Company's confession of judgment held in escrow by BMS.

In July 1996, an action was commenced against Porta and certain present and former directors in the Supreme Court of the State of New York, New York County by certain stockholders and warrant holders of Porta who acquired their securities in connection with the acquisition by Porta of Aster Corporation. The complaint alleges breach of contract against Porta and breach of fiduciary duty against the directors arising out of an alleged failure to register certain restricted shares and warrants owned by the plaintiffs. The complaint seeks damages of \$413,000; however, counsel for the plaintiff have advised Porta that additional plaintiffs may be added and, as a result, the amount of damages claimed may be substantially greater than the amount presently claimed. Porta believes that the defendants have valid defenses to the claims. Discovery is proceeding, although there has been no significant activity in this matter subsequent to December 31, 1999.

### (21) Cash Flow Information

(1) Supplemental cash flow information for the years ended December 31, is as follows:

	2000	1999	1998
	-----	-----	-----
Cash paid for interest	\$3,763	3,117	2,629
	=====	=====	=====
Cash paid for income taxes	\$ 183	379	223
	=====	=====	=====

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

#### (2) Non-cash transactions:

(i) During 1998, the Company exchanged approximately \$250,000 principal amount of its Debentures, net of unamortized discount and accrued interest, for 5,000 shares of common stock, and \$192,000 of Notes, (note 7).

(ii) During 1998, the Company issued 53,000 shares of common stock upon the conversion of Notes valued at approximately \$280,000 (note 7).

(iii) During 1998, the Company issued 330,000 shares of common stock upon the conversion of \$1,260,000 of Debentures (note 7)

(iv) During 1998, the Company issued 147,000 shares of common stock valued at approximately \$500,000 to satisfy a portion of the final settlement of a class action lawsuit (note 10).

(v) In connection with advisory services provided in 1997 by an investment banking firm, the Company issued 120,000 shares of common stock in 1998 valued at approximately \$340,000 (notes 7 and 10).

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(vi) In 1998, in connection with the subordinated notes, the Company issued Series B and Series C Warrants, which were valued at \$630,000 and were recorded as part of additional paid in capital and original issue discount (note 8).

(vii) In 1999, in connection with advisory services provided by an investment banking firm, the Company issued 150,000 shares of common stock valued at approximately \$113,000 (notes 7 and 10).

(viii) In 1999, Porta incurred a non-cash charge of \$56,000 as a result of the reduction in the exercise price of the Series B and Series C Warrants (note 8).

(ix) In 2000, Porta incurred a non-cash charge of \$140,000 as a result of the issuance New Warrants (note 8).

(x) In 2000, Porta incurred a non-cash charge of \$169,000 as a result of the reduction in the exercise price of the Warrants issued to its senior lender (note 6).

(xi) In 2000, Porta incurred a non-cash charge of \$129,000 as a result of Warrants issued to its senior lender in connection with an increase in its revolving line of credit to its senior lender (note 6).

(xii) In 2000, Porta incurred a non-cash charge of \$59,000 as a result of the reduction in the exercise price of the Warrants issued to its senior lender in connection with a waiver of default (note 6).

(Continued)

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### PORTA SYSTEMS CORP. AND SUBSIDIARIES Notes to Consolidated Financial Statements, Continued

#### (22) Segment and Geographic Data

Porta has three reportable segments: Line Connection and Protection Equipment ("Line") whose products interconnect copper telephone lines to switching equipment and provides fuse elements that protect telephone equipment and personnel from electrical surges; Operating Support Systems ("OSS") whose products automate the testing, provisioning, maintenance and administration of communication networks and the management of support personnel and equipment; and Signal Processing ("Signal") whose products are used in data communication devices that employ high frequency transformer technology.

The factors used to determine the above segments focused primarily on the types of products and services provided, and the type of customer served. Each of these segments is managed separately from the others, and management evaluates segment performance based on operating income.

	2000	1999	1998
	----	----	----
Revenue:			



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Line	\$ 20,546,000	18,189,000	24,291,000
OSS	22,296,000	14,254,000	27,318,000
Signal	7,644,000	6,328,000	7,539,000
	-----	-----	-----
	\$ 50,486,000	38,771,000	59,148,000
	=====	=====	=====
Segment profit:			
Line	\$ 3,665,000	3,582,000	6,580,000
OSS	(6,201,000)	(10,650,000)	(365,000)
Signal	2,088,000	1,884,000	1,953,000
	-----	-----	-----
	\$ (448,000)	(5,184,000)	8,168,000
	=====	=====	=====
Depreciation and amortization:			
Line	\$ 424,000	505,000	722,000
OSS	1,262,000	881,000	1,170,000
Signal	162,000	199,000	200,000
	-----	-----	-----
	\$ 1,848,000	1,585,000	2,092,000
	=====	=====	=====
Total identifiable assets:			
Line	\$ 8,508,000	7,921,000	10,330,000
OSS	14,942,000	21,637,000	28,283,000
Signal	6,591,000	7,965,000	8,176,000
	-----	-----	-----
	\$ 30,041,000	37,523,000	46,789,000
	=====	=====	=====
Capital expenditures:			
Line	\$ 340,000	415,000	280,000
OSS	1,132,000	670,000	283,000
Signal	45,000	27,000	93,000
	-----	-----	-----
	\$ 1,517,000	1,112,000	656,000
	=====	=====	=====

(Continued)

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements, Continued

The following table reconciles segment totals to consolidated totals:

	2000
	----
Revenue:	
Total revenue for reportable segments	\$ 50,486,000
Other revenue	654,000
	-----
Consolidated total revenue	\$ 51,140,000
	=====

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Operating income (loss):	
Total segment profit (loss) for reportable segments	\$ (448,000)
Corporate and unallocated	(4,705,000)
	-----
Consolidated total operating income (loss)	\$ (5,153,000)
	=====
Depreciation and amortization:	
Total for reportable segments	\$ 1,848,000
Corporate and unallocated	63,000
	-----
Consolidated total depreciation and amortization	\$ 1,911,000
	=====
Total assets:	
Total for reportable segments	\$ 30,041,000
Corporate and unallocated	4,133,000
	-----
Consolidated total assets	\$ 34,174,000
	=====
Capital expenditures:	
Total for reportable segments	\$ 1,517,000
Corporate and unallocated	16,000
	-----
Consolidated total capital expenditures	\$ 1,533,000
	=====

The following table presents information about the Company by geographic area:

	2000	1999	1998
	----	----	----
Revenue:			
United States	\$17,225,000	14,368,000	18,951,000
United Kingdom	20,244,000	15,673,000	20,441,000
Asia/Pacific	5,429,000	4,159,000	7,181,000
Other Europe	2,482,000	3,130,000	3,337,000
Latin America	146,000	1,257,000	7,463,000
Other North America	5,570,000	296,000	1,879,000
Other	44,000	53,000	51,000
	-----	-----	-----
Consolidated total revenue	\$51,140,000	38,936,000	59,343,000
	=====	=====	=====
Consolidated long-lived assets:			
United States	\$12,115,000	12,011,000	13,317,000
United Kingdom	1,107,000	2,398,000	2,520,000
Other North America	568,000	618,000	663,000
Asia/Pacific	612,000	200,000	273,000
Latin America	14,000	35,000	26,000
Other	3,000	8,000	11,000
	-----	-----	-----
Current and other assets	14,419,000	15,270,000	16,810,000
	-----	-----	-----
Consolidated total assets	\$34,174,000	43,448,000	53,136,000
	=====	=====	=====

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PORTA SYSTEMS CORP. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements, Continued

## (23) Quarterly Information (Unaudited)

The following presents certain unaudited quarterly financial data:

	Quarter Ended		
	March 31, 2000	June 30, 2000	Septem
Net sales	\$ 15,928,000	\$ 13,828,000	\$ 1
Gross profit	5,716,000	3,570,000	
Net income (loss)	306,000	(2,887,000)	(
Net income (loss) per share:			
Basic	\$ 0.03	\$ (0.30)	\$
Diluted	\$ 0.03	\$ (0.30)	\$

	Quarter Ended		
	March 31, 1999	June 30, 1999	Septem
Net sales	\$ 9,526,000	\$ 9,109,000	\$
Gross profit	2,811,000	2,639,000	
Net loss	(1,744,000)	(2,940,000)	(
Net loss per share:			
Basic	\$ (0.18)	\$ (0.31)	\$
Diluted	\$ (0.18)	\$ (0.31)	\$

Net loss for the quarter ended December 31, 2000 reflects an accrual associated with the reduction of overhead and headcount, and consolidation of OSS operations of approximately \$900,000.

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