PORTA SYSTEMS CORP
Form 10-K
March 31, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

[x] 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, 2002

[ ] 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.)
6851 Jericho Turnpike, Syosset, New York (Address of principal executive offices)	11791 (Zip Code)
Registrant's telephone number, including area code:	(516) 364-9300

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, par value $.01 per share

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 X No ___.

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

Indicate by a check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes__ No X

State aggregate market value of the voting stock held by non-affiliates of the registrant: $598,767 as of June 30, 2002.

Indicate the number of shares outstanding of each of the registrant's class of common stock, as of the latest practicable date: 9,972,284 shares of Common Stock, par value $.01 per share, as of March 19, 2003.

DOCUMENTS INCORPORATED BY REFERENCE

None

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Part I

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 operations 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 6851 Jericho Turnpike, Syosset, New York 11791; telephone number, 516-364-9300. References to "we," "us," "our," and words of like import refer to Porta Systems Corp. and its subsidiaries, unless the context indicates otherwise.

Forward-Looking Statements

Statements in this Form 10-K annual report may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, statements that express our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions. These statements are based on current expectations, estimates and projections about our business based, in part, on assumptions made by management. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may, and probably will, differ materially from what is expressed or forecasted in the forward-looking statements due to numerous factors, including those risks discussed from time to time in this Form 10-K annual report, including the risks described under "Risk Factors" and in other documents which we file with the Securities and Exchange Commission and the matters described under "Management's Discussion and Analysis of Financial Condition and Results of Operations." In addition, such statements could be affected by risks and uncertainties related to our financial conditions, factors which affect the telecommunications industry, market and customer acceptance, competition, government regulations and requirements and pricing, as well as general industry and market conditions and growth rates, and general economic conditions. Any forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Form 10-K.

Risk Factors

We require substantial financing to meet our working capital requirements and our principal lender has no obligation to provide us with any additional financing. We had a working capital deficit at December 31, 2002 of $34,199,000. As of December 31, 2002, our current liabilities included $25,070,000 due to our senior lender, all of which becomes due on May 15, 2003. We do not have sufficient resources to pay the senior lender when our obligations to the senior lender mature on May 15, 2003, or to pay principal and interest of $8,444,000 due at December 31, 2002 on the outstanding subordinated notes that became due on July 3, 2001, and we do not expect to generate the necessary cash from our operations to enable us to make those payments. Because our senior lender is no longer advancing funds to us, at present our only source of funds is from operations. To the extent that our operations do not generate sufficient funds to cover our expenses, it may be necessary for us to seek reorganization or liquidation under the Bankruptcy Code. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

We are incurring losses from our operations, and our losses are continuing. We incurred a net loss of $4,114,000, or $0.41 per share (basic and diluted), on sales of $21,417,000 for 2002, following a loss of $14,774,000, or $1.50 per share (basic and diluted) for 2001. In each of these years, our revenue declined significantly from the level of the previous year. Our losses are continuing and we expect that our losses will continue unless we are able both to significantly increase our revenue and reduce our expenses. We cannot give assurance that we will be able to operate profitably in the future, and if we are unable to operate profitably, we may be unable to continue in business.

Because of our decreasing revenues together with problems facing both the telecommunications industry and the economy, we may not be able to continue in business. Our sales declined significantly from 2000 to 2001 and again from 2001 to 2002. Unless we are able to stop the downward trend in sales and generate a significant increase in sales, our reduction in overhead will not be sufficient to enable us to sustain our operations. We cannot assure you that we will be able to increase our sales significantly, if at all. As a result of the deterioration of our operating revenue we are evaluating various options, including the sale of one or more of our divisions as well as a reorganization or liquidation under the Bankruptcy Code.

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 2002, 2001 and 2000, our stockholders' deficit of $29,935,000 at December 31, 2002, and our working capital deficit of $34,199,000 as of December 31, 2002 our auditors included in their report an explanatory paragraph about our ability to continue as a going concern.

Because of our financial condition, we have not been able to pay certain of our creditors on a timely basis, and some of our creditors have obtained judgments against us. As a result of our continuing financial difficulties, a number of creditors have engaged attorneys or collection agencies or commenced legal actions against us, and some of them have obtained judgments against us. Claimants who have already either commenced litigation or otherwise sought collection are due approximately $214,000. If we are unable to reach a settlement with these creditors and others who have not yet brought claims, and these claimants obtain judgments against us or seek to enforce a judgment against us, it may be necessary for us, or our senior lender may require us, to seek protection under the Bankruptcy Code.

Our largest customer has ceased placing orders for OSS products with us and has significantly decreased orders for our copper connection/protection products, which are having a material adverse effect upon our business. Our largest customers are British Telecommunications and Fujitsu Telecommunications LTD, which purchases telecommunications equipment from us for sale to British Telecommunications. Sales to British Telecommunications declined significantly during the past year. British Telecommunications has informally advised us that it will not place orders with us for OSS products until we can demonstrate that we are financially viable. The decline in sales of connection/protection products for British Telecommunications reflects both our financial condition and industry conditions generally. We have not been able to replace the sales made to British Telecommunications and we cannot give any assurance that we will be able to. The reluctance of British Telecommunications to place orders for OSS products may affect the willingness of other telecommunications companies to order new OSS or other products from us. The reduced level of our sales resulting from the decline in sales to British Telecommunications is continuing to impair our business, and, if we are not able to replace these sales, or generate new business from British Telecommunications or Fujitsu, we may not be able to continue in business.

Since we sell to telecommunications companies, our sales are affected by economic and other factors that affect that industry, both domestically and internationally. During the past three years, the telecommunications industry has been affected by an international slowdown, and many, if not most, telecommunications companies have scaled back plans for expansion, which has resulted in a significant drop in the requirements for products including products such as our OSS products and our connection/protection products. We cannot assure you that there will be any positive change in the purchasing patterns of telecommunications companies or that we will benefit from any positive change which may occur.

Because of our financial condition, we may not be able to perform on our contracts which may subject us to loss of business and penalties. We are having and we may continue to have difficulty performing our obligations under our contracts, which could result in the cancellation of contracts, the loss of future business and penalties for non-performance.

We are heavily dependent on foreign sales. Approximately 54% of our sales in 2002 and 2001 and 66% of our sales for 2000, 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, as well as further risks relating to political and economic changes. Furthermore, our financial condition has impaired our ability to generate new business in the international market as potential customers express concern about our ability to perform.

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 has resulted and may continue to result in a significant decline in our sales to British Telecommunications.

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. 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. As a result, it is possible that we may lose money on Operations Support Systems contracts.

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. Our competitors are using our financial difficulties in successfully competing against us. We anticipate that our loss for 2002, our working capital deficiency and absence of financing 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.

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. Because of our financial problems, we are not able to devote any significant effort to research and development, which could increase our difficulties in making sales of our products.

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. Because of our financial problems we have experienced key personnel losses. To the extent that these losses continue or are accelerated, we may be unable to provide our customers with necessary service, which could result in the failure to generate new business.

Our stock is subject to the penny stock rules, which may make it difficult for stockholders to sell our stock. Because our stock is traded on the OTC Bulletin Board and our stock price is very low, our stock is subject to the Securities and Exchange Commission's penny stock rules, which impose additional sales practice requirements on broker-dealers which sell our stock to persons other than established customers and institutional accredited investors. These rules may affect the ability of broker-dealers to sell our common stock and may affect the ability of our stockholders to sell any common stock they may own.

We do not pay dividends on common stock.

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, We develop software to meet specific customer requirements, including integration of its systems with telephone company legacy or third party OSS systems.

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.

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.

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 our major categories of the telecommunications industry:

Sales by Product Category

	Years Ended December 31,					
	2002		2001		2000	
	(Dollars in thousands)					
OSS Systems	$ 6,414	30%	$ 8,874	32%	$22,296	44%
Line Connecting /Protecting Equipment	9,598	45%	12,756	46%	20,546	40%
Signal Processing	4,523	21%	5,737	20%	7,644	15%
Other	882	4%	695	2%	654	1%
Total	$21,417	100%	$28,062	100%	$51,140	100%

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 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 2002, approximately 30% 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 2002, approximately 45% 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 2002, signal processing equipment accounted for approximately 21% of our sales.

Marketing and Sales

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

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, We continues to promote the direct marketing relationships it developed in the past with telephone operating companies.

British Telecommunications purchased line connecting/protecting products amounting to $689,000 (3% of sales) in 2002, $3,339,000 (12% of sales) in 2001, and $4,261,000 (8% of sales) in 2000. During these years, we also sold our products to unaffiliated suppliers for resale to British Telecommunications. We have a cross-licensing agreement with British Telecommunications 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.

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. This agreement expired during September 2002.Under the agreement, Fujitsu sold and marketed our 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. During 2002, we had no sales pursuant to this agreement. During 2001 and 2000, we had sales pursuant to this agreement of $3,200,000 (11% of sales) and $12,051,000 (24% of sales), respectively.

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

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,					
	2002		2001		2000	
	(Dollars in thousands)					
North America	$10,442	49%	$13,356	48%	$22,795	45%
United Kingdom	6,388	30%	8,060	29%	20,244	40%
Asia/Pacific	2,725	13%	4,552	16%	5,429	10%
Other Europe	1,600	7%	1,761	6%	2,482	5%
Latin America	258	1%	288	1%	146	0%
Other	4	0%	45	0%	44	0%
Total Sales	$21,417	100%	$28,062	100%	$51,140	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, we face 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 we establish facilities in foreign countries or to the extent that payment is denominated in the local currency, we face risks associated with currency devaluation, inability to convert local currency into dollars, as well as 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, file servers 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 Syosset, 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.

Source and Availability of Components

We generally purchase the standard components used in the manufacture of our products from a number of suppliers. We attempt to assure ourselves that the components are available from more than one source. We purchase all of our MKIII test units from one supplier. We purchase the majority of our workstations and servers used in our OSS systems from Hewlett Packard Corporation. However, we could use other computer equipment in our systems if we were unable to purchase Hewlett Packard 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 the years ended December 31, 2002, 2001 and 2000, our five largest customers accounted for sales of $9,784,000, or approximately 46% of sales, $13,444,000, or approximately 48% of sales, and $28,323,000, or approximately 55% of sales, respectively. Our largest customer in 2002 and 2001 with sales of $2,725,000 and $3,485,000, or approximately 13% and 12%, respectively, of sales was Philippine Long Distance Telephone. Our largest customer in 2000 with sales of $12,051,000, or approximately 24% of sales was Fujitsu Telecommunications. Our sales to Fujitsu Telecommunications were $3,200,000, or approximately 11% of sales in 2001. 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. Direct sales to British Telecommunications were $2,306,000, or 11% of sales, for 2002,

$3,339,000, or 12% of sales, for 2001 and $5,098,000, or 10% of sales, for 2000. 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 in 2002, 2001 or 2000.

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, 2002, our backlog was approximately $4,400,000 compared with approximately $6,100,000 at December 31, 2001. Of the December 31, 2002 backlog, approximately $3,300,000 represented orders from foreign telephone operating companies. We expect to ship substantially all of our December 31, 2002 backlog during 2003.

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, and the decision of British Telecommunications not to place orders for new OSS products from us and its reduced level of purchases of copper connection/protection products may place us at a competitive disadvantage in seeking new business and new orders for existing customers.

Research and Development Activities

We spent approximately $2,500,000 in 2002, $4,400,000 in 2001, and $5,800,000 in 2000 on research and development activities. All research and development was company sponsored and is expensed as incurred. As a result of our financial difficulties, we have scaled down our research and development effort, which could hurt our ability to offer competitive products.

Employees

As of March 7, 2003, we had 258 employees of which 56 were employed in the United States, 176 in Mexico, 18 in the United Kingdom, 3 in Poland, 4 in Chile, and 1 in China. 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, 2003.

Item 2. Properties

We currently lease approximately 14,500 square feet of executive, sales, marketing and research and development space and 4,200 square feet of manufacturing space in Syosset, New York. These facilities represent substantially all of our office, plant and warehouse space in the United States. The Syosset, New York leases expire February 2008 and May 2007, respectively. The annual rental related to the New York property is approximately $277,000.

Our wholly-owned United Kingdom subsidiary leases approximately 11,000 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 $114,000.

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

We believe our properties are adequate for our needs.

Item 3. Legal Proceedings

In July 2001, the holder of a subordinated note in the principal amount of $500,000 commenced an action against us in the United States District Court for the Southern District of New York seeking payment of the principal and accrued interest on their subordinated notes which were payable in July 2001. The payment of the note is subordinated to payment of our senior debt and we believe that the subordination provision of the note prohibits payment by us. The plaintiff's motion for a summary judgment was denied by the court on the grounds that the terms of the note did not give them permission to obtain a judgment while we remained in default to the senior debt holder. Our obligations under the subordinated notes are reflected as current liabilities on our balance sheet.

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. The complaint asserted 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. We filed an answer and counterclaim against the plaintiffs. During 2002, we settled all claims related to this action for $30,000.

In July 1996, an action was commenced against us and certain present and former directors in the Supreme Court of the State of New York, New York County by certain of our stockholders and warrant holders of Porta who acquired their securities in connection with our acquisition of Aster Corporation. The complaint alleges breach of contract against us and breach of fiduciary duty against our 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 us that additional plaintiffs may be added and, as a result, the amount of damages claimed may be substantially greater than the amount presently claimed. We believe that we have valid defenses to the claims. Discovery is proceeding, although there has been no significant activity in this matter subsequent to

December 31, 1999.

In June 2002, BMS Corp. served an arbitration demand on us claiming that we breached our agreement to market and sell an update to our MLR product which BMS was to develop. We believe that we have defenses to the claims by BMS and have filed a counterclaim to recover the $350,000 we advanced to BMS under the contract. The arbitrators have recently been selected and the proceedings will move forward over the next several months.

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

During the fourth quarter of 2002, no matters were submitted to a vote of our security holders.

Part II

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

Our common stock is traded on the OTC Bulletin Board under the symbol PYTM. Prior to November 11, 2002, our stock was traded on the American Stock Exchange under the symbol PSI. The following table sets forth, for 2001 and 2002, the quarterly high and low sales prices for our common stock on the consolidated transaction reporting systems for the OTC Bulletin Board and American Stock Exchange listed issues.

		High	Low
2001	First Quarter	$1.06	$0.22
	Second Quarter	0.40	0.21
	Third Quarter	0.30	0.10
	Fourth Quarter	0.17	0.05
2002	First Quarter	$0.20	$0.07
	Second Quarter	0.10	0.06
	Third Quarter	0.15	0.03
	Fourth Quarter	0.08	0.005

We did not declare or pay any cash dividends in 2002 or 2001. 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 our common stock in the foreseeable future. In addition, our agreement with our senior lender prohibits it from paying cash dividends on its common stock.

As of March 19, 2003, we had approximately 979 stockholders of record and the closing price of our common stock was $0.04.

We did not issue any unregistered securities during 2002.

Equity Compensation Plan Information

The following table summarizes the equity compensation plans under which our securities may be issued as of December 31, 2002.

Equity Compensation Plan Information as of December 31, 2002

Plan Category	Number of securities to be issued upon exercise of outstanding options and warrants	Weighted-average exercise price of outstanding options and warrants	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	844,030	$2.25	698,470
Equity compensation plan not approved by security holders	-0-	-0-	95,750
	844,030	$2.25	794,220

The plan not approved by security holders is a stock bonus plan that permits issuance of stock on a discretionary basis.

Item 6. Selected Financial Data

The following table sets forth certain selected consolidated financial information. 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:

	Year Ended December 31,				
	2002	2001	2000	1999	1998
	(In thousands, except per share data)				
Income Statement Data:					
Sales	$ 21,417	$ 28,062	$ 51,140	$ 38,936	$ 59,343
Operating income (loss)	(2,881)	(11,453)	(5,153)	(9,709)	4,566
Debt conversion expense	--	--	--	--	(945)
Income (loss) before extraordinary item	(4,114)	(14,774)	(10,176)	(13,686)	451
Net income (loss)	(4,114)	(14,774)	(10,176)	(13,686)	527

Basic per share amounts:					
Continuing operations	$ (0.41)	$ (1.50)	$ (1.04)	$ (1.44)	0.05
Net income (loss)	$ (0.41)	$ (1.50)	$ (1.04)	$ (1.44)	$ 0.06
Diluted per share amounts:					
Continuing operations	$ (0.41)	$ (1.50)	$ (1.04)	$ (1.44)	$ 0.04
Net income (loss)	$ (0.41)	$ (1.50)	$ (1.04)	$ (1.44)	$ 0.05
Cash dividends declared	--	--	--	--	--
Number of shares used in calculating net income (loss) per share-basic	9,994	9,878	9,763	9,489	9,281
Number of shares used in calculating net income (loss) per share-diluted	9,994	9,878	9,763	9,489	9,785
Balance Sheet Data:					
Total assets	$ 14,228	$ 17,833	$ 34,174	$ 43,448	$ 52,136
Working capital (deficiency)	$(34,199)	$(31,236)	$(24,152)	$ 6,135	$ 14,262
Current debt maturities	$ 31,599	$ 28,621	$ 26,890	$ 2,000	$ 2,000
Long-term debt excluding current maturities	$ -0-	$ -0-	$ 376	$ 21,902	$ 17,238
Stockholders' equity (deficit)	$(29,935)	$(25,849)	$(10,792)	$ (1,387)	$ 11,984

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

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in conformity with accounting principles accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in those financial statements. These judgments can be complex and consequently actual results could differ from those estimates. Among the more significant estimates included in these consolidated financial statements are revenue recognition, allowance for doubtful accounts receivable, inventory reserves, goodwill valuation and the deferred tax asset valuation allowance. Note 1 of Notes to Consolidated Financial Statements, included elsewhere on this annual report on Form 10-K, includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements.

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, principally OSS 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. The percentage-of-completion method is based on judgments and estimates that are complex and actual results may differ from estimates.

Allowance for Doubtful Accounts Receivable

We record an allowance for doubtful accounts receivable based on specifically identified amounts that we believe to be uncollectible. We also record additional allowances based on certain percentages of our aged receivables, which are determined based on historical experience and our assessment of the general financial conditions affecting our customer base. If our actual collections experience changes, revisions to our allowance may be required. We have a limited number of customers with individually large amounts due at any given balance sheet date. Any unanticipated change in one of those customers' credit worthiness, or other matters affecting the collectability of amounts due from such customers, could have a ma