

PERFORMANCE TECHNOLOGIES INC \DE\  
Form 10-K  
March 06, 2012

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

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**FORM 10-K**

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

**For the fiscal year ended December 31, 2011**

OR

**[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

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

**Commission File Number 0-27460**

**PERFORMANCE TECHNOLOGIES,  
INCORPORATED**

**Incorporated pursuant to the Laws of the State of Delaware**

**Internal Revenue Service – Employer Identification No. 16-1158413**

**205 Indigo Creek Drive, Rochester, New York 14626**

(585) 256-0200

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

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
<b>Common Stock, par value \$0.01 per share</b>	<b>NASDAQ Global Market</b>

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

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

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

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

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

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 the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ X ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company. Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ X ]

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the close of business on June 30, 2011 was approximately \$17,272,625, based on the closing price of the registrant's common stock on the NASDAQ Global Market on that date.

The number of shares outstanding of the registrant's Common Stock, \$.01 par value, was 11,116,397 as of February 29, 2012.

#### DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Registrant's definitive proxy statement relating to the May 24, 2012 Annual Meeting of Stockholders are specifically incorporated by reference in Part III, Items 10, 11, 12, 13 and 14 of this Annual Report on Form 10-K, except for the equity plan information required by Item 12 as set forth therein.

**Performance Technologies, Incorporated**  
**Index to Annual Report on Form 10-K**

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## **PART I**

### **SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

The Private Securities Litigation Reform Act of 1995 (the "Reform Act") provides a "safe harbor" for forward-looking statements. Certain written and oral statements made by management of Performance Technologies, Incorporated and its subsidiaries (collectively "PT") include forward-looking statements intended to qualify for the safe harbor from liability established by the Reform Act. These forward-looking statements generally can be identified by words such as "believes," "expects," "anticipates," "projects," "foresees," "forecasts," "estimates" or other words or phrases of similar import. Words such as the "Company," "PT," "management," "we," "us," or "our," mean Performance Technologies, Incorporated and its subsidiaries. All statements herein that describe PT's business strategy, outlook, objectives, plans, intentions, goals or similar projections are also forward-looking statements within the meaning of the Reform Act.

All such forward-looking statements are subject to certain risks and uncertainties and should be evaluated in light of important risk factors. These risk factors include, but are not limited to, the following as well as those that are described in "Risk Factors" under Item 1A and elsewhere in this Annual Report on Form 10-K: business and economic conditions, rapid technological changes accompanied by frequent new product introductions, competitive pressures, dependence on key customers, inability to gauge order flows from customers, fluctuations in quarterly and annual results, the reliance on a limited number of third party suppliers, limitations of our manufacturing capacity and arrangements, the protection of our proprietary technology, errors or defects in our products, the effects of pending or threatened litigation, the dependence on key personnel, changes in critical accounting estimates, potential impairments related to investments, foreign regulations, possible loss or significant curtailment of significant government contracts or subcontracts and potential material weaknesses in internal control over financial reporting. In addition, during weak or uncertain economic periods, customers' visibility deteriorates causing delays in the placement of their orders. These factors often result in a substantial portion of the Company's revenue being derived from orders placed within a quarter and shipped in the final month of the same quarter.

Any of these factors could cause PT's actual results to differ materially from its anticipated results. For a more detailed discussion of these factors, see the "Risk Factors" discussion in Item 1A in this Annual Report on Form 10-K. The Company cautions readers to carefully consider such factors. Many of these factors are beyond the Company's control.

#### **Available Information**

The Company's website address is [www.pt.com](http://www.pt.com). The Company makes available free of charge via a hypertext link on its website, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). The Company will provide this information upon written request to the attention of the Chief Financial Officer, Performance Technologies, Incorporated, 205 Indigo Creek Drive, Rochester, New York 14626. Materials we provide to the SEC are also available for the public to read and copy through the SEC website at [www.sec.gov](http://www.sec.gov) or at the SEC Public Reference Room at 100 F Street, N.E. Washington, D.C. 20549 or by calling 1-800-SEC-0330.

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## **ITEM 1 – Business**

### **Overview**

Performance Technologies, Incorporated (“PT”), a Delaware corporation founded in 1981, is a global supplier of advanced network communications solutions to service providers, government and OEM markets.

PT’s product portfolio includes IP-centric network elements and applications designed for high availability, scalability, and long life cycle deployments. The industry-leading Monterey 8000™ MicroTCA and IPnexus® Platforms anchor a growing portfolio of PT solutions. OEMs and application developers, including PT itself, leverage the robust carrier grade Linux® development environment and rich suite of communications protocols (PT’s NexusWare®) of our Application-Ready Platforms as a cornerstone component of their end product value proposition. PT’s SEGway™ Signaling Solutions provide affordable, high density signaling, advanced routing for LTE and IMS applications, IP migration, gateway capabilities, SIP bridging, and core-to-edge distributed intelligence, as well as features such as Number Portability and SMS Spam Defense. The Company’s Xpress™ NGN applications enable evolving Mobile 2.0, Multi-media, and IMS-based revenue-generating services.

PT is headquartered in Rochester, New York and maintains direct sales and marketing offices in the U.S. in Raleigh, North Carolina and Chicago, Illinois and international offices in London, England and Shanghai, China, and has centers of engineering excellence in San Diego, California, and Kanata, Ontario, Canada, in addition to Rochester, New York.

### **Strategy**

The Company’s strategy is to maximize the value proposition of its products by leveraging its field-proven systems, software and hardware technologies. Management believes the tightly integrated combination of these technologies provides considerable benefits to PT’s customers including a compelling return-on-investment proposition, significant development risk mitigation and a substantially accelerated time-to-market opportunity.

Management is focused on building on the momentum generated in 2011 and will continue to concentrate on the four



network communications-focused initiatives established in 2010 to construct a solid foundation for long-term growth. These initiatives include further strengthening our SEGway Signaling Systems product line, continued evolution and enhancement of our open-standards based Application-Ready Platforms for mission critical communications applications, intensifying our market diversification efforts in government systems markets, and identifying forward-looking network communications growth opportunities, such as our Xpress portfolio of SIP-based applications and enabling infrastructure, that we can pursue with our own end product solutions.

Our signaling product portfolio, which is targeted at the service provider market, has reached a scale in terms of features, functionality and cost-effectiveness that generates strong interest on a global basis and especially in many emerging markets. As a result, beginning in 2011, our sales and marketing strategy for our signaling products became more focused on working with strong channel partners as our primary vehicle to further expand our reach in the global and emerging markets. To that end, we added GENBAND as a strong channel partner in January 2011, Kapsch CarrierCom AG in the third quarter 2011, and we continue to work closely under our established relationship with Alcatel-Lucent as another major channel partner.

From an expense perspective, in the fourth quarter 2009, management proactively undertook several new investments to further position PT for growth in anticipation that business conditions would improve. The timing of these investments was based upon forward-looking market data that we expected would drive opportunities for our technologies. It became apparent during the second half of 2010 that the economic and industry trends that occurred did not drive growth for PT's products to the degree expected. Therefore, in December 2010, PT announced an expense reduction program to substantially reduce its operating expenses by consolidating our San Luis Obispo, California engineering operation with our Rochester, New York engineering group and also reducing our sales and marketing staff. Management believes that while it was necessary to make these reductions for financial reasons, the significant strategic investments made during 2010 were important in underpinning a solid foundation for long-term future growth.

There are identifiable risks associated with PT's strategy in the current economic climate. While management believes that its network communications market focus offers opportunities for growth in the long term, network infrastructure investments by carriers are very sluggish; the total available market for traditional SS7-based signaling products is declining and the market for SIP-based next-generation network products is not yet growing as rapidly as anticipated. Despite the current economic climate, which may involve new risks not currently identified, management believes the outlook for the Company's profitability is improving because expenses have been aligned with projected revenues and our new channel partners are engaged in selling our products.

## **Market Overview**

PT's business addresses one industry segment – Communications, and globally targets two primary vertical markets for its network communications products: telecommunications, and military, aerospace and government systems.

The telecommunications market, historically our largest vertical market, is fundamentally driven by investments in network infrastructure by carriers and service providers. Telecommunications market revenues derived from our Application-Ready Platforms, which are sold to OEMs, depend primarily on broad, multi-year deployments of next-generation telecommunications infrastructure. Telecommunications market revenues generated from service providers purchasing our SEGway and Xpress product lines result from investments necessary to support existing and evolving service demands such as text messaging and the transition to Internet-based communications networks.

Sales into the military, aerospace and government systems market are typically to prime contractors and system integrators and reflect investment levels by various government agencies and military branches in specific programs and projects requiring enhanced communications capabilities. Military, aerospace and government systems budgets are currently under pressure and shipments are subject to project deployment schedules, which are often unpredictable.

During 2011, the economy recovered unevenly around the world and business conditions continued to remain very challenging in the telecommunications equipment market. The norm in our OEM business is that OEM customers place orders for product only when they have orders in hand from their customers and then expect almost immediate delivery. Revenues from our telecommunications customers grew by \$5.0 million, or 22%, in 2011, compared to 2010. The opportunity for government funded network infrastructure and military related expenditures remains positive but the timing of awarded business for the most part is highly unpredictable. Revenues from the military, aerospace and government systems market customers grew by \$3.3 million, or 61% in 2011, compared to 2010. Our Xpress product line is generating interest from both telecommunications and government customers. PT successfully completed a pilot program with a government customer during the fourth quarter 2011 to demonstrate the Xpress products' capabilities in a communications cost reduction program. The first contract award for this program is expected during 2012. Forward-looking visibility on customer orders remains very challenging.

## Products

PT's product portfolio includes SEGway Signaling Solutions, Monterey and IPnexus Application-Ready Platforms and Xpress SIP Applications. In January 2011, PT expanded its signaling product portfolio with the acquisition of GENBAND's Universal Signaling Platform ("USP") and SP2000 signaling technology.

***SEGway Signaling Solutions:*** SEGway Signaling Solutions provide low cost, high density signaling, advanced routing, IP migration, gateway capabilities, SIP bridging, and core-to-edge distributed intelligence. PT's product suite of IP-centric STPs, gateways, edges, and network applications permits service providers to cost effectively deliver revenue generating features in current and next-generation networks. SEGway solutions have been deployed in numerous world-class carrier networks around the globe because of their high density and unparalleled price-to-performance ratio. This, together with SEGway's flexibility in edge-to-core deployments, small footprint, and ease of use, has earned the portfolio its reputation as "Simply Smarter Signaling®."

Deployed for over ten years, PT's SEGway Signaling solutions, which are built on our Application-Ready Platforms, provide a full suite of signaling capabilities that seamlessly operate in both circuit-switched and IP-based networks to address the signaling needs of wireless and wireline carriers and service providers.

In January 2011, PT acquired the Universal Signaling Point and SP2000 signaling products from GENBAND. In addition, PT has a long-term agreement to provide GENBAND with development, support and maintenance of signaling solutions as integral elements of GENBAND's premier switching portfolio.

***Monterey and IPnexus Application-Ready Platforms:*** PT's Monterey and IPnexus Application-Ready Platforms anchor a growing portfolio of PT solutions. These platforms are built on PT's own U.S. manufactured hardware combined with PT's NexusWare Carrier Grade Linux operating system and software development environment. PT's Application-Ready Platforms are IP-native, designed for high availability, scalability, and long life cycle deployments. OEMs and application developers, including PT itself, leverage PT's carrier grade Linux development environment and suite of communications protocols (NexusWare) as a cornerstone component of their end product value proposition.

**In November 2011, PT's Monterey 8000 platform, the newest member of the Monterey MicroTCA family of products, received the Best of Show-Hardware Award by the Advanced MicroTCA Summit.**

In November 2011, PT's Monterey 8000 platform, the newest member of the Monterey MicroTCA family of products

Management believes that the tightly integrated combination of systems, hardware and software technologies found in the Company's Application-Ready Platforms provides measurable benefits to its customers through development risk mitigation and substantially accelerated time-to-market metrics. Furthermore, the Monterey and IPnexus product lines are built upon a fundamental premise of long life cycle deployment that is fully supported by PT, as opposed to offerings from some of our competitors.

***Xpress SIP Applications:*** PT introduced its Xpress product line in 2010. Xpress is a portfolio of SIP-based applications and enabling infrastructure for next-generation network (NGN) architectures. Today, in addition to the Xpress scalable Application Server and its associated Service Creation Environment, PT offers four Xpress applications including Prepaid/Postpaid services, Voice Messaging, Private Network Cost Optimizer and Telemarketer Guard™. Adoption of voice-over-packet architectures by wireless and wireline carriers, and the emergence of SIP (Session Initiation Protocol) as the predominant next-generation network protocol have presented new opportunities for service providers to market media-rich and web-friendly applications to their subscribers. PT's Xpress product portfolio represents a new approach for delivering these capabilities in a cost effective manner. Based on a pure IP implementation, new service offerings can be quickly developed and readily deployed, network wide, on IMS-enabled, converged TDM/IP and VoIP networks.

### **Sales, Marketing and Distribution**

PT markets its products worldwide to a variety of customers through its direct sales force and various channel partners including OEMs, Value Added Resellers (VARs), distributors and systems integrators. While more emphasis is being placed on channel sales for our service provider customers, currently the majority of PT's business is conducted through PT's direct sales organization.

Due to the highly technical nature of PT's products, it is essential that PT's salespeople are technically oriented and are knowledgeable in the communications, networking and embedded systems fields. To supplement its sales force, PT has customer engineers who assist prospective customers in determining if PT's products will meet their requirements.

At year end 2011, PT had a total of 35 sales, marketing and sales support personnel located in various U.S. offices including: Rochester, New York; Raleigh, North Carolina; Chicago, Illinois; San Jose, California and internationally in London, England and Shanghai, China. Beginning in 2011, our sales and marketing strategy for our signaling products became more focused on working with strong channel partners as our primary vehicle to further expand our reach in global and emerging markets. To that end, we added GENBAND as a strong channel partner in January 2011, Kapsch CarrierCom AG in the third quarter 2011, and we continue to work closely under our established relationship with Alcatel-Lucent as another major channel partner. In addition, PT had a total of fourteen individual and corporate independent sales representatives and agents at December 31, 2011.

PT executes various ongoing marketing strategies designed to attract new customers and to stimulate additional business with existing customers. These strategies include web-based activities, technology seminars, direct mail and email campaigns, active participation in technical standards groups, participation in regional, national and international trade shows, placement of selected trade press advertisements and the authoring of technical articles.

Management believes that the tightly integrated combination of systems, hardware and software technologies found

Sales to customers outside of the United States represented 46%, 58% and 53% of PT's revenue in 2011, 2010 and 2009, respectively. In 2011 and 2010, export shipments to the United Kingdom represented 20% and 26% of sales, respectively. International sales are subject to risks of import and export controls, transportation delays and foreign governmental regulations. Payments for shipments from the United States to outside the United States are generally made in U.S. dollars.

## Customers

PT has approximately 110 customers worldwide in the telecommunications and military, aerospace and government systems markets. Many of PT's major customers are Fortune 1000 companies in the United States or companies of similar stature in Europe, Africa and Asia. In 2011, PT's two largest customers represented 19% and 7% of sales, respectively, and PT's four largest together represented 38% of sales. In 2010, PT's two largest customers represented 24% and 5% of sales, respectively, and PT's four largest customers together represented 39% of sales. In 2009, PT's two largest customers represented 15% and 10% of sales, respectively, and PT's four largest customers together represented 36% of sales.

In 2011, approximately 76% of PT's revenue came from the telecommunications industry and 24% from the military, aerospace and government systems market.

**SEGway Signaling Solutions Customers:** Announced customers for our SEGway Signaling Solutions include Alcatel-Lucent, Alltel Communications (now Verizon), Bakcell Ltd., Cable and Wireless Guernsey, Comfone, Elephant Talk, Ericsson, GENBAND, GeoLink, Globacom, Hawaiian Telcom, Kapsch CarrierCom AG, Leap Wireless/Cricket, Pocket Communications, Primus Telecommunications, Siemens, Starcomms, Syniverse, Telefonica Moviles Espana, Tata Communications (formerly Teleglobe) and VeriSign.

**Monterey and IPnexus Application-Ready Platform Customers:** Announced customers for our Application-Ready Systems include: Aeroflex, Alcatel-Lucent, Aviat Networks, AudioCodes, FAA, General Dynamics, Honeywell, Lockheed Martin, Metaswitch Networks, Motorola, Nokia Siemens, Northrup Grumman, Raytheon, Rockwell Collins, Stratus Technologies, Sun Microsystems (now Oracle Corporation) and Unisys.

The loss of one or more of our larger customers, the reduction, delay or cancellation of orders, or a delay in shipment of our products to such customers, would have a material adverse effect on our revenue and operating results. During 2012, Metaswitch Networks is expected to begin a transition away from using PT's IPnexus platforms in some of its product offerings. As a result, a significant reduction of shipments to Metaswitch is expected during 2012.

## Backlog

The scheduled backlog of orders amounted to \$7.7 million and \$6.0 million at February 1, 2012 and 2011, respectively. The year-over-year increase is primarily due to the effect of revenue remaining to be recognized on the Company's signaling systems sale to a customer in Africa, which totals \$1.2 million. Substantially all of the backlog amounts for 2012 are expected to be shipped and recognized in revenue prior to the end of the year. Orders are received unevenly, which makes comparison of backlog not particularly relevant. Orders are subject to postponement of delivery or cancellation in the normal course of business. A substantial portion of PT's revenue in each quarter results from orders placed within the quarter and shipped in the final month of the same quarter. Due to the global economic climate, forward-looking visibility on customer orders continues to be very challenging. (See Management's Discussion & Analysis included elsewhere in this report).

SEGway Signaling Solutions Customers: Announced customers for our SEGway Signaling Solutions include Alcatel



## Seasonality

PT's business is not generally subject to large seasonal swings but business is frequently slower during the summer months due to the European and United States vacation seasons. Some of PT's customers have seasonal swings in their business which are reflected in their orders with PT. Much of PT's OEM business is project-related, which can cause quarterly fluctuations in revenue.

## Environmental Matters

PT complies with U.S. federal, state and local laws relating to the protection of the environment and believes that environmental matters do not have any material effect on its capital expenditures, earnings or competitive position. Further, PT complies with national laws relating to the protection of the environment in all end country markets served by export sales.

If the products that we produce in the future do not comply with a country's laws relating to the protection of the environment, we would be unable to sell our products into those markets and our operating results would be harmed.

## Competition

PT's SEGway Signaling solutions satisfy a wide range and scale of signaling requirements, most of which typically involve some component of utilizing Internet Protocol (IP) to carry signaling traffic. PT's SEGway Signaling solutions currently compete with products from Tekelec, Huawei, Ericsson, Nokia-Siemens Networks and Cisco Systems.

Embedded purpose-built computer platforms are either based on proprietary technology or are based on open standards. PT's Monterey and IPnexus Application-Ready Platforms are open standards based, which is the smaller portion of this market. A key differentiating factor of PT's Application-Ready Platforms is PT's internally developed NexusWare Carrier Grade Linux operating system and software development environment. We believe this is a key competitive advantage in our marketplace because many of PT's competitors provide third party operating systems with their products.

The OEM communications equipment market is characterized by rapid technological change and frequent introduction of products based on new technologies. Competitive factors in this market include price, product performance, functionality, product quality and reliability, customer service and support, marketing capability, corporate reputation and brand recognition, and changes in relative price/performance ratios. PT's Monterey and IPnexus Application-Ready Platforms compete in certain open standards-based markets, specifically AdvancedTCA, MicroTCA and CompactPCI 2.16.

Competitors providing some level of systems offerings include Emerson, Radisys, GE Fanuc and Kontron. Currently these companies sell into the AdvancedTCA, MicroTCA and CompactPCI 2.16 parts of the market. PT offers MicroTCA and CompactPCI 2.16 products and does not sell AdvancedTCA platforms. Management believes that PT's capability to deliver fully integrated, system-level platforms with a substantial software component including its NexusWare is a key differentiating factor for PT's products.

Monterey and IPnexus Application-Ready Platform Customers: Announced customers for our Application-Ready S

We cannot guarantee that we will be able to compete successfully with our existing or new competitors or that the competitive pressures faced by us will not have a material adverse effect on our revenue and operating results.

## **Research and Development**

PT's research and development expenses were approximately \$7.1 million, \$7.8 million and \$7.8 million in 2011, 2010, and 2009, respectively, and were net of capitalized software development costs of \$2.0 million, \$2.3 million and \$2.3 million, respectively. These expenses consist primarily of personnel costs, material consumed in developing and designing new products, and amounts expended for software licenses/tools. PT expects to continue to invest heavily in research and development in order to create innovative next-generation products and maintain competitive advantages in the communications markets we serve. Research and development expenses declined in 2011 over 2010 primarily due to a reduction in force announced in December 2010.

In addition, in January 2011, the Company acquired GENBAND's Universal Signaling Platform and SP2000 signaling technology at a cost of \$4.3 million. PT is further developing the SP2000 product and is selling both products to GENBAND. This technology was recorded in purchased intangible assets.

During the fourth quarter 2010, PT licensed signaling technology from Alcatel-Lucent for \$.2 million. During 2011, PT successfully integrated this technology into its signaling product portfolio and delivered it to its first customer. This technology was recorded in property, equipment and improvements. Similarly, in 2009, PT paid a one-time license fee of \$.8 million to acquire certain software technologies, which PT combined with its captive technologies and released as its Xpress product line in 2010. This technology was recorded in purchased intangible assets.

PT has significant core competencies associated with advanced network communications and control solutions. PT provides remotely manageable, IP-centric network solutions, elements and applications specifically engineered for high availability, scalability, and long life cycle deployments. Its products are built upon our own U.S. manufactured hardware combined with PT's NexusWare Carrier Grade Linux operating system and software development environment plus a broad suite of communications protocols and high availability middleware.

### **Proprietary Technology**

PT's success depends in part upon retaining and maximizing its proprietary technologies. To date, PT has relied principally upon trademark, copyright and trade secret laws to protect its proprietary technology. PT generally enters into confidentiality or license agreements with its customers, distributors and potential customers that contain confidentiality provisions, and limits access to, and distribution of, the source code to its software and other proprietary information. All of PT's employees are subject to PT's employment policy regarding confidentiality. PT's software products are provided to customers under license, generally in the form of object code, which has provided a high degree of confidentiality with respect to the underlying intellectual property.

### **Manufacturing and Suppliers**

In a fast-paced technology environment, product life cycles generally extend for two to four years. The obsolescence by manufacturers of individual electronic components used by PT is occurring more rapidly than ever before. During 2010, PT completed the transition of its printed circuit board assembly for the hardware elements of PT's products to a contract manufacturer, Mack Technologies, Inc. ("Mack"), based near Boston, Massachusetts. The purpose of this transition was to bring tangible benefits to PT, which includes more predictable product costs, a significant reduction in capital expenditure requirements, and an enhanced ability to continue to offer cutting-edge technologies in PT's product lines without sacrificing PT's high standards of quality. PT performs all integration and final testing steps of its products at its Rochester facility. The outsourcing of all printed circuit board assembly to one contract

Monterey and IPnexus Application-Ready Platform Customers: Announced customers for our Application-Ready S

manufacturer presents additional risks, including reliance on Mack's on-time delivery, the quality of Mack's products, and Mack's financial wherewithal.

Mack is responsible for the acquisition of most of the electronic components that go into the Company's printed circuit board products. Mack has considerably larger buying power based on its procurement budget than PT had on a stand-alone basis. Still, lack of availability of components can cause delays in shipments. In addition, the costs and time delays caused by redesigning specific products when components are not available has become a challenging factor in several cases.

There can be no assurance that future component supplies will be adequate for the Company's needs or will be available on prices and terms acceptable to PT. Mack's or PT's inability in the future to obtain sufficient limited-source components, or to develop alternative sources, could result in delays in product introduction or shipments; and increased component prices could negatively affect PT's gross margins, either of which would have a material adverse effect on PT's revenue and operating results.

In addition to utilizing Mack for printed circuit board assembly, PT also outsources the fabrication of other elements of its product lines, such as system chassis, metalwork and plastic components, to various third party suppliers. In the event of an interruption of production at PT's outsourcing vendors or its Rochester manufacturing facility, PT's ability to deliver products in a timely fashion would be compromised, which would have a material adverse effect on PT's results of operations.

## Employees

As of December 31, 2011, PT had 143 full-time and three part-time employees, and one engineering cooperative education student. Management believes its relations with its employees are generally good. PT's employees are not subject to collective bargaining agreements.

PT's full-time employees work in the following areas:

Research and Development	60
Sales and Marketing	35
Manufacturing	32
General and Administrative	16
Total	143

Management believes that PT's future success will depend on its ability to continue to attract and retain qualified personnel.

## ITEM 1A Risk Factors

**Our global growth is subject to a number of economic risks.**

Our revenue and profitability depend on the overall demand for our products and related services and the successful implementation of our strategy. While the economy in the United States is slowly recovering from the great recession of 2008, the government debt crisis in Europe continues to severely diminish liquidity and credit availability for

There can be no assurance that future component supplies will be adequate for the Company's needs or ~~will~~ be av

European economies. There can be no assurance that there will not be a further deterioration in financial markets and confidence in major economies. These economic developments affect businesses such as ours in a number of ways. Tightening of credit in financial markets adversely affects the ability of our customers to obtain financing for significant purchases and operations and could result in a decrease in or cancellation of orders for our products and services as well as impact the ability of our customers to make payments. Similarly, tight credit may adversely affect our supplier base and increase the potential for one or more of our suppliers to experience financial distress or bankruptcy.

Our global business is also adversely affected by decreases in the general level of economic activity, such as decreased capital expenditures by telecommunications service providers, decreases in general business and consumer spending, and government procurement. Many carriers/service providers have been cautious of making investments in infrastructure during difficult economic times, which customarily results in reduced budgets and spending. This can impact us through reduced revenues, elongated selling cycles, delays in product implementation and increased competitive margin pressure. Fluctuations in the rate of exchange for the U.S. Dollar against certain major currencies such as the Euro, the Pound Sterling, the Canadian Dollar and other currencies also tend to make our products more or less costly for foreign customers which can adversely affect our results. We are unable to predict the likely duration and severity of the current adverse economic conditions in the U.S. and other countries, and are unable to fully anticipate the effect that the current economic conditions will have on our business.

**If we do not respond adequately to technological change, our competitive position will decline.**

The market for our products is generally characterized by rapid technological change and frequent introduction of products based on new technologies. Although we have continued to enhance or introduce new elements within our IPnexus Application-Ready Platform offerings, this product family has been in the marketplace for eight years. Application of our IPnexus Application-Ready platforms, especially as targeted at the telecommunications industry, is volatile as the effects of new technologies, new standards, and new products contribute to changes in the market and the performance of industry participants. Although we have continued to enhance and introduce new features within our SEGway Signaling Solutions, this product family has been in the marketplace for more than ten years. The replacement for signaling protocols in IP-based networks has been defined and next-generation products with this new protocol are currently available. Our future revenue will depend upon our ability to anticipate technological changes and to develop and introduce enhanced products on a timely basis that meet customer requirements and comply with industry standards. New product introductions, or the delays thereof, could contribute to quarterly fluctuations in operating results as orders for new products commence and orders for existing products decline. Moreover, significant delays can occur between product introduction and commencement of volume production, typically twelve to eighteen months. The inability to develop and manufacture new products in a timely manner, the existence of reliability, quality or availability problems in our products or their component parts, or the failure to achieve market acceptance for our products would have a material adverse effect on our revenue and operating results. Further, current technologies may become obsolete before being replaced by new technologies, which would have a material adverse effect on our revenue and operating results.

**We operate in an extremely competitive industry and our revenues and operating results will suffer if we do not compete effectively.**

The communications marketplace we are focused on is extremely competitive. We face a number of large and small competitors. Many of our principal competitors have established brand name recognition and market positions and have substantially greater experience and financial resources than we do to deploy on promotion, advertising, research and product development. In addition, we expect to face competition from new competitors. Companies in related markets could offer products with functionality similar or superior to that offered by our products. Increased competition could result in price reductions, reduced margins and loss of market share, all of which would materially and adversely affect our revenue and operating results. Several of our competitors have recently been acquired. These acquisitions are likely to permit our competition to devote significantly greater resources on the development and marketing of new competitive products and the marketing of existing competitive products to their larger installed



bases. We expect that competition will increase substantially as a result of these and other industry consolidations and alliances, as well as the emergence of new competitors. We cannot guarantee that we will be able to compete successfully with our existing or new competitors or that the competitive pressures faced by us will not have a material adverse effect on our revenue and operating results.

**We depend on a number of key customers, the loss of any of which, or the substantially decreased demand from which, would harm our revenues and operating results.**

We cannot assure that our principal customers will continue to purchase products from us at current levels. Customers typically do not enter into long-term volume purchase contracts with us and customers have certain rights to extend or delay the shipment of their orders. During 2012, Metaswitch Networks is expected to begin a transition away from using PT's IPnexus platforms in some of its product offerings. As a result, a significant reduction of shipments to Metaswitch is expected during 2012. The loss of one or more of our major customers, the reduction, delay or cancellation of orders, or a delay in shipment of our products to such customers, would have a material adverse effect on our revenue and operating results.

**Carriers and service providers in our target markets are experiencing consolidation which could delay or cancel ongoing network infrastructure expansion and upgrade programs.**

The global telecommunications industry is experiencing consolidation. While these activities may strengthen the industry in the long term, they are often disruptive to ongoing capital programs and projects in the short term. These disruptions and delays can have a material adverse effect on our revenue and operating results.

**Our annual and quarterly results can fluctuate greatly, which can have a disproportionate effect on net income and the price of our common stock.**

Our future annual and quarterly operating results can fluctuate significantly depending on factors such as the timing and shipment of significant orders, new product introductions by us and our competitors, market acceptance of new and enhanced versions of our products, changes in pricing policies by us and our competitors, inability to obtain sufficient supplies of sole or limited source components for our products, and general economic conditions. Our expense levels are based, in part, on our expectations as to future revenue. Since a substantial portion of our revenue in each quarter results from orders placed within the quarter and often shipped in the final weeks of that quarter, revenue levels are difficult to predict. If revenue levels are below expectations, operating results will be adversely affected. Net income would be disproportionately affected by a reduction in revenue because only a small portion of our net expenses varies with our revenue. In addition, our common stock is thinly traded and fluctuations in operating results can cause significant fluctuations in the price of our common stock.

**We depend on a limited number of third-party suppliers to provide us and our contract manufacturer with important components for our products. If we were unable to obtain components from these suppliers, our revenue and operating results would suffer.**

In a fast-paced technology environment, product life cycles extend for approximately two to four years and the obsolescence by manufacturers of individual electronic components used by the Company is occurring more rapidly than ever before. Certain components used in our products are currently available to us from only one or a limited number of sources. There can be no assurance that future supplies will be adequate for our needs or will be available on prices and terms acceptable to us. Our inability in the future to obtain sufficient limited-source components, or to develop alternative sources, could result in delays in product introduction or shipments, and increased component

prices could negatively affect our gross margins, either of which would have a material adverse effect on our revenue and operating results.

**Potential limitations in our manufacturing arrangements could impair our ability to meet our customers' expectations.**

In order to fulfill orders for customers in the most optimal manner for a volume and mix of business, we have historically manufactured the majority of our products at our Rochester, New York facility. However, in 2010, we outsourced the manufacturing of all our printed circuit board assemblies for our products to an outside contract manufacturer. In addition, certain elements of these products, such as platform chassis, are manufactured by other contract manufacturers. We do not have alternative manufacturing capabilities to manufacture our products. Even if we were able to identify alternative third-party contract manufacturers, we cannot assume that we would be able to retain their services on terms and conditions acceptable to us. In the event of an interruption in production or damage to our manufacturing facility from a natural disaster or other catastrophic event, either of which would cause interruptions or delays in our manufacturing process, we would not be able to deliver products on a timely basis, which would have a material adverse effect on our revenue and operating results. Although we currently have business interruption insurance, we cannot be assured that such insurance would adequately cover our lost business as a result of such an interruption.

**If we do not adequately protect our proprietary technology, or if we infringe on the intellectual property rights of others, our revenues and operating results would suffer.**

Our success, in part, depends upon our proprietary technologies. To date, we have relied principally upon trademark, copyright and trade secret laws to protect our proprietary technologies. We generally enter into confidentiality or license agreements with our customers, distributors and potential customers and limit access to, and distribution of, the source code to our software and other proprietary information. Our employees are subject to our employment policy regarding confidentiality. We cannot assure that the steps taken by us in this regard will be adequate to prevent misappropriation of our technologies or to provide an effective remedy in the event of a misappropriation by others.

Because of the existence of an extremely large number of patents in the communications industry and the rapid rate of new patents granted or new standards or new technology developed, we may have to obtain technology licenses from others. We do not know whether these third party technology licenses will be available to us on commercially reasonable terms. The loss of, or inability to obtain, any of these technology licenses could result in delays or reductions in our product shipments. Any such delays or reductions in product shipments would have a material adverse effect on our revenue and operating results. Furthermore, although we believe that our products do not intentionally infringe on the proprietary rights of third parties, we cannot assure that infringement claims will not be asserted, resulting in costly litigation in which we may not ultimately prevail. Adverse determinations in such litigation could result in the loss of our proprietary rights, subject us to significant liabilities, and require us to seek licenses from third parties or prevent us from manufacturing or selling our products, any of which would have a material adverse effect on our revenue and operating results.

**We depend on a number of key personnel. The loss of these people, or delays in replacing them, would harm our operating results.**

Our success depends on the continued contributions of our personnel, many of whom would be difficult to replace, if they left us. Changes in personnel could adversely affect our operating results. In addition, although our employees are subject to our employment policy regarding confidentiality and ownership of inventions, employees are generally not subject to employment agreements or non-competition covenants and thus they could compete with us if they left our employment.

**We may hold investments in companies from time to time. These investments or other future investments are subject to potential impairment.**

We hold investments in privately held companies from time to time. We may make additional investments in the future in these or other companies. Depending upon the future fortunes of these companies in meeting their operating objectives, an impairment charge or reserves could be recorded on these investments in the future. The occurrence of a future impairment or additional reserve would adversely affect our results of operations.

**We are subject to certain foreign regulations that restrict the distribution of products containing certain substances. Failure to comply with these foreign regulations would harm our operating results.**

Foreign and domestic governmental agencies periodically issue directives pertaining to the distribution of products which contain certain substances. While we believe we are in full compliance with all such existing directives, if in the future the products that we produce do not comply with existing or similar directives, we would be unable to sell our products into those markets and our operating results would be harmed.

**Errors or defects in our products could result in disputes, litigation and product liability claims by our customers and could diminish demand for our products, injure our reputation and adversely affect our operating results.**

Our products are very complex and may contain errors or defects that could be detected at any point in the life of the product. While we have rigorous quality control and testing procedures for our products, we can provide no absolute assurances that errors or defects will not be found in our products until deployment or long after a product has been deployed. Our products, even if error free, must interoperate with other vendors' equipment in our customers' networks and such operation could result in technical problems with our products. A warranty or product liability claim brought against us could result in costly, highly disruptive and time-consuming litigation, which could harm our business. Although our agreements with our customers contain provisions designed to limit our exposure to potential warranty and product liability claims, it is possible that these limitations may not be effective to cover all claims. Although we maintain product liability insurance, it may not be sufficient to cover all claims to which we may be subject. Errors and defects or failures to properly interoperate, could cause diminished demand for our products, delays in market acceptance and sales, diversion of development resources, injury to our reputation, increased service and warranty costs or could result in disputes, litigation and product liability losses with our customers. If any of these were to occur, there would be a material adverse effect to our revenue and operating results.

**In future periods, we may experience material weaknesses in our internal control over financial reporting, which could adversely affect our ability to report our financial condition and results of operations accurately and on a timely basis.**

Material weaknesses in our internal control over financial reporting could adversely impact our ability to provide timely and accurate financial information. If we identify material weaknesses, we may not be able to timely or accurately report our financial condition, results of operations or cash flows or maintain effective disclosure controls and procedures. If we are unable to report financial information timely and accurately or to maintain effective

disclosure controls and procedures, we could be subject to, among other things, regulatory or enforcement actions, securities litigation, and a general loss of investor confidence, any one of which could adversely affect our business prospects and the valuation of our common stock.