UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/Amendment No. 1

(Mark One)

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended JUNE 30, 2002

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: 0-10355

COMMUNICATIONS SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| MINNESOTA | 41-0957999 |
| (State or other jurisdiction of incorporation or organization) | (Federal Employer Identification No.) |
| 213 South Main Street, Hector, MN | 55342 |
| (Address of principal executive offices) | (Zip Code) |

(320) 848-6231

Registrant's telephone number, including area code

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| CLASS | Outstanding at July 31, 2002 |
|---|---|
| Common Stock, par value $.05 per share | 8,277,741 |

Total Pages (16) Exhibit Index at (NO EXHIBITS)

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

INDEX

## PART I. FINANCIAL INFORMATION

## COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

### Item 1. Financial Statements

### CONSOLIDATED BALANCE SHEETS
(unaudited)

| | June 30 2002 | December 31 2001 |
|---|---|---|
| Assets: | | |
| Current assets: | | |
| Cash | $ 21,966,994 | $ 22,239,883 |
| Trade receivables, net | 20,290,863 | 19,182,828 |
| Inventories | 27,205,404 | 24,931,739 |
| Note Receivable | | 2,765,390 |
| Deferred income taxes | 2,716,405 | 2,176,405 |
| Other current assets | 290,012 | 556,906 |
| Total current assets | 72,469,678 | 71,853,151 |
| Property, plant and equipment | 34,058,488 | 32,955,036 |
| less accumulated depreciation | (26,251,624) | (24,818,363) |
| Net property, plant and equipment | 7,806,864 | 8,136,673 |
| Other assets: | | |
| Excess of cost over net assets acquired | 5,295,585 | 4,638,068 |
| Deferred income taxes | 3,070,027 | 3,070,027 |
| Other assets | 344,804 | 313,884 |
| Total other assets | 8,710,416 | 8,021,979 |
| Total Assets | $ 88,986,958 | $ 88,011,803 |
| Liabilities and Stockholders' Equity: | | |
| Current liabilities: | | |
| Notes payable | $ 7,000,000 | $ 9,000,000 |
| Accounts payable | 6,430,529 | 5,567,390 |
| Accrued expenses | 3,941,448 | 3,890,113 |
| Deferred revenue | 3,133,149 | |
| Income taxes payable | 1,374,898 | 2,246,299 |
| Total current liabilities | 21,880,024 | 20,703,802 |
| Stockholders' Equity | 67,106,934 | 67,308,001 |
| Total Liabilities and Stockholders' Equity | $ 88,986,958 | $ 88,011,803 |

See notes to consolidated financial statements.



<TABLE>
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## COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF (LOSS) INCOME AND COMPREHENSIVE (LOSS) INCOME
(unaudited)

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2002 | 2001 | 2002 | 2001 |
| <S> | <C> | <C> | <C> | <C> |
| Sales | $ 27,174,589 | $ 25,681,533 | $ 51,094,929 | $ 48,775,810 |
| Costs and expenses: | | | | |

| | | | | |
|---|---|---|---|---|
| Cost of sales | 22,539,883 | 18,733,338 | 40,083,612 | 35,185,584 |
| Selling, general and administrative expenses | 6,163,756 | 6,569,156 | 11,889,018 | 13,008,979 |
| Total costs and expenses | 28,703,639 | 25,302,494 | 51,972,630 | 48,194,563 |
| Operating income (loss) | (1,529,050) | 379,039 | (877,701) | 581,247 |
| Other income and (expenses): | | | | |
| Investment income | 54,530 | 226,365 | 130,434 | 469,503 |
| Interest expense | (57,696) | (160,170) | (150,093) | (340,788) |
| Other income, (expense) net | (3,166) | 66,195 | (19,659) | 128,715 |
| Income (loss) before income taxes | (1,532,216) | 445,234 | (897,360) | 709,962 |
| Income taxes (benefit) | (490,000) | 130,000 | (325,000) | 210,000 |
| Net income (loss) | (1,042,216) | 315,234 | (572,360) | 499,962 |
| Other comprehensive income (loss): | | | | |
| Unrealized holding gain (loss) on debt securities | | (22,838) | | 5,288 |
| Foreign currency translation adjustment | 263,982 | (5,386) | 196,332 | (185,437) |
| Other comprehensive income ( loss) before income taxes | 263,982 | (28,224) | 196,332 | (180,149) |
| Income tax expense (benefit) related to unrealized loss on debt securities | | (7,916) | | 1,798 |
| | 263,982 | (20,308) | 196,332 | (181,947) |
| Comprehensive income (loss) | $ (778,234) | $ 294,926 | $ (376,028) | $ 318,015 |
| Basic net income (loss) per share | $ (.13) | $ .04 | $ (.07) | $ .06 |
| Diluted net income (loss) per share | $ (.13) | $ .04 | $ (.07) | $ .06 |
| Average Basic Shares Outstanding | 8,264,487 | 8,391,380 | 8,263,918 | 8,425,243 |
| Average Dilutive Shares Outstanding | 8,267,646 | 8,400,278 | 8,270,100 | 8,445,937 |

See notes to consolidated financial statements.

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(unaudited)

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Cumulative Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| BALANCE AT DECEMBER 31, 2000 | 8,616,909 | $ 430,846 | $ 28,877,135 | $ 42,309,918 | $ (350,971) | $ 71,266,928 |
| Net income | | | | 712,249 | | 712,249 |
| Issuance of common stock under Employee Stock Purchase Plan | 15,657 | 783 | 82,363 | | | 83,146 |
| Issuance of common stock to Employee Stock Ownership Plan | 25,000 | 1,250 | 219,075 | | | 220,325 |
| Purchase of stock | (395,252) | (19,763) | (1,323,044) | (1,885,563) | | (3,228,370) |
| Shareholder dividends | | | | (1,673,467) | | (1,673,467) |
| Other comprehensive loss | | | | | (72,810) | (72,810) |
| BALANCE AT DECEMBER 31, 2001 | 8,262,314 | 413,116 | 27,855,529 | 39,463,137 | (423,781) | 67,308,001 |
| Net loss | | | | (572,360) | | (572,360) |
| Issuance of common stock to Employee Stock Ownership Plan | 25,000 | 1,250 | 187,250 | | | 188,500 |
| Issuance of common stock under Employee Stock Option Plan | 1,700 | 85 | 11,645 | | | 11,730 |
| Purchase of stock | (2,762) | (138) | (9,333) | (15,798) | | (25,269) |
| Other comprehensive income | | | | | 196,332 | 196,332) |
| BALANCE AT JUNE 30, 2002 | 8,286,252 | $ 414,313 | $ 28,045,091 | $ 38,874,979 | $ (227,449) | $ 67,106,934 |

</TABLE>

See notes to consolidated financial statements.



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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

| | Six Months Ended June 30 2002 | Six Months Ended June 30 2001 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| <S> | <C> | <C> |
| Net income (loss) | $ (572,360) | $ 499,962 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,570,744 | 2,617,515 |
| Changes in assets and liabilities net of effects of the purchase of MiLAN Technology Corporation: | | |
| Trade receivables | 1,524,624 | 4,600,361 |
| Inventories | 2,920,977 | (147,924) |
| Other current assets | 266,929 | 210,409 |
| Accounts payable | 791,746 | (191,829) |
| Accrued expenses and deferred revenue | 2,909,116 | (285,250) |
| Income taxes payable | (1,411,407) | (137,162) |
| Net cash provided by operating activities | 8,000,369 | 7,166,082 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (935,740) | (712,192) |
| Maturities of mortgage-backed and other investment securities | | 5,747,354 |
| Other assets | (68,766) | 18,661 |
| Collection of notes receivable | 2,765,390 | 200,000 |

| | | |
|---|---|---|
| Payment for purchase of MiLAN Technology Corporation | (8,058,932) | |
| Net cash provided by (used in) investing activities | (6,298,048) | 5,253,823 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Repayment of notes payable | (2,000,000) | (20,882) |
| Dividends paid | | (1,717,643) |
| Proceeds from issuance of stock | 11,730 | |
| Purchase of stock | (25,269) | (2,344,302) |
| Net cash used in financing activities | (2,013,539) | (4,082,827) |
| EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH | 38,329 | 15,134 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (272,889) | 8,352,212 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 22,239,883 | 11,321,374 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 21,966,994 | $ 19,673,586 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Income taxes paid | $ 455,641 | $ 347,969 |
| Interest paid | 211,617 | 377,716 |

See notes to consolidated financial statements.

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS

The balance sheet and statement of changes in stockholders' equity as of June 30, 2002, the statements of (loss) income and comprehensive (loss) income for the three and six month periods ended June 30, 2002 and 2001 and the statements of cash flows for the six-month periods ended June 30, 2002 and 2001 have been prepared by the Company without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows at June 30, 2002 and 2001 and for the six months then ended have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested these condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's December 31, 2001 Annual Report to Shareholders. The results of operations for the periods ended June 30 are not necessarily indicative of the operating results for the entire year.

In February 2002, the Company issued 25,000 shares of the Company's common stock to the Employee Stock Ownership Plan in payment of its 2001 obligation. In a noncash transaction, the Company recorded additional stockholders' equity of $188,500 (reflecting the market value of the stock at the time of the contribution) and reduced accrued expenses by the same amount.

NOTE 2 - NET INCOME PER SHARE

Basic net (loss) income per common share is based on the weighted average number of common shares outstanding during each year. Diluted net (loss) income per common share takes into effect the dilutive effect of potential common shares outstanding. The Company's only potential common shares outstanding are stock options. The Company calculates the dilutive effect of outstanding options using the treasury stock method.

NOTE 3 - ACQUISITIONS

Effective March 25, 2002 the Company acquired substantially all of the assets and assumed certain liabilities of Digi International Inc.'s MiLAN legacy business. The business has been reincorporated as MiLAN Technology Corporation. Located in Sunnyvale, California, MiLAN is a growing provider of leading edge wireless telecommunications products for businesses and residences, managed and unmanaged LAN switches, media conversion products and print servers. The Company expects the MiLAN acquisition will be both complementary and supplementary to its Transition Networks business by increasing the product offerings and expanding the customer bases of both business units.

The operations of MiLAN are included in the Company's financial results from the purchase date. In the acquisition, the following assets were acquired and liabilities assumed:

| | |
|---|---|
| Accounts receivable | $ 2,426,713 |
| Inventory | 5,121,936 |
| Plant and equipment | 234,971 |
| Excess of cost over net assets acquired | 910,170 |
| Accrued expenses | (566,039) |
| Total purchase price | $ 8,127,751 |

The Company believes the excess of cost over net assets acquired in this transaction has an indefinite useful life and is not subject to amortization.



NOTE 4 - INVENTORIES

Inventories summarized below are priced at the lower of first-in, first-out cost or market:

| | June 30 2002 | December 31 2001 |
|---|---|---|
| Finished Goods | $ 9,429,563 | $ 15,821,487 |
| Raw Materials | 17,775,841 | 9,110,252 |
| Total | $ 27,205,404 | $ 24,931,739 |

NOTE 5 - OTHER ASSETS

Effective January 1, 2002, the company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." SFAS 142 provides a new methodology for evaluating goodwill impairment. While we have not yet completed the necessary calculations, we anticipate that upon adoption the methodology prescribed by SFAS 142 for evaluating and measuring the impairment of goodwill will result in a goodwill impairment charge for Suttle Apparatus which had $1,262,000 of goodwill at June 30, 2002. Once the calculations are finalized, any charge will be reported as a cumulative effect of change in accounting principle against first quarter 2002 earnings. We will be required by SFAS No. 142 to assess, on at least an annual basis, whether our goodwill carrying value has incurred additional impairment. Amortization of intangible assets that the Company determines to have finite useful lives will continue. Amortization expense for those assets will be approximately $33,400 annually.

The following table summarizes operating and net (loss) income for the six months ended June 30, 2002 and 2001, and proforma amounts for 2001 excluding amortization expense recognized in that period related to goodwill:

| | Six Months Ended June 30 | | |
|---|---|---|---|
| | 2002 | 2001 | 2001 Pro forma |
| Revenues | $ 51,094,929 | $ 48,775,810 | $ 48,775,810 |
| Gross Margin | 11,011,317 | 13,590,226 | 13,590,226 |
| Operating (Loss) Income | (877,701) | 581,247 | 1,616,991 |
| Income Before Income Taxes | (897,360) | 709,962 | 1,745,706 |
| Income Taxes | (325,000) | 210,000 | 527,000 |
| Net (Loss) Income | (572,360) | 499,962 | 1,218,706 |
| Basic Net (Loss) Income Per Share | $ (.07) | $ .06 | $ .14 |
| Diluted Net (Loss) Income Per Share | $ (.07) | $ .06 | $ .14 |



NOTE 6 - SEGMENT INFORMATION

The Company classifies its businesses into four segments: Suttle, which manufactures U.S. standard modular connecting and wiring devices for voice and data communications; Austin Taylor, which manufactures British standard line jacks, patch panels, wiring harness assemblies, metal boxes, distribution cabinets and central office frames; Transition Networks and MiLAN Technology (substantially all assets of MiLAN purchased March 25, 2002), which designs and markets data transmission, computer network and media conversion products and print servers; and JDL Technologies (JDL) which provides telecommunications network design, specification and training services to educational institutions. Information concerning the Company's operations in the various segments for the six-month periods ended June 30, 2002 and 2001 is as follows:
<TABLE>
<CAPTION>

| | Suttle | Austin Taylor | Transition Networks/MiLAN | JDL Technologies | Corporate | Consolidated |
|---|---|---|---|---|---|---|
| Six Months Ended June 30, 2002: | | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Revenues | $ 16,815,072 | $ 3,701,551 | $ 20,291,979 | $ 10,286,327 | $ 0 | $ 51,094,929 |
| Cost of sales | 15,481,098 | 3,285,097 | 13,899,790 | 7,417,627 | 0 | 40,083,612 |
| Gross profit | 1,333,974 | 416,454 | 6,392,189 | 2,868,700 | 0 | 11,011,317 |
| Selling, general and administrative expenses | 3,316,437 | 465,001 | 5,486,803 | 1,777,396 | 843,381 | 11,889,018 |
| Operating income (loss) | $ (1,982,463) | $ (48,547) | $ 905,386 | $ 1,091,304 | $ (843,381) | $ (877,701) |
| Depreciation and amortization | $ 1,081,505 | $ 232,361 | $ 148,878 | $ 60,000 | $ 48,000 | $ 1,570,744 |
| Capital expenditures | $ 422,768 | $ 15,186 | $ 475,313 | $ (1,462) | $ 23,935 | $ 935,740 |
| Assets | $ 48,599,053 | $ 5,681,714 | $ 20,731,950 | $ 6,955,750 | $7,018,491 | $ 88,986,958 |
| Six Months Ended June 30, 2001: | | | | | | |
| Revenues | $ 20,837,696 | $ 5,797,026 | $ 17,374,202 | $ 4,766,886 | $ 0 | $ 48,775,810 |
| Cost of sales | 16,881,625 | 4,945,715 | 10,700,290 | 2,657,954 | 0 | 35,185,584 |
| Gross profit | 3,956,071 | 851,311 | 6,673,912 | 2,108,932 | 0 | 13,590,226 |
| Selling, general and administrative expenses | 3,557,103 | 781,326 | 5,017,559 | 1,625,513 | 2,027,478 | 13,008,979 |
| Goodwill amortization | 143,524 | 29,169 | 640,774 | 222,277 | (1,035,744) | 0 |
| Operating income (loss) | $ 255,444 | $ 40,816 | $ 1,015,579 | $ 261,142 | $ (991,734) | $ 581,247 |
| Depreciation and amortization | $ 1,148,273 | $ 308,182 | $ 819,424 | $ 282,277 | $ 59,359 | $ 2,617,515 |
| Capital expenditures | $ 397,255 | $ 15,186 | $ 46,787 | $ 68,590 | $ 184,374 | $ 712,192 |
| Assets | $ 47,131,700 | $ 6,926,429 | $ 20,175,355 | $ 5,444,187 | $9,047,349 | $ 88,725,020 |

</TABLE>

Information concerning the Company's operations in the various segments for the three-month periods ended June 30, 2002 and 2001 is as follows:



<TABLE>
<CAPTION>

| | Suttle | Austin Taylor | Transition Networks/MiLAN | JDL Technologies | Corporate |
|---|---|---|---|---|---|

| | | | | | | Consolidated |
|---|---|---|---|---|---|---|
| Three Months Ended June 30, 2002: | | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Revenues | $ 8,532,050 | $ 1,805,156 | $ 10,738,896 | $ 6,098,487 | $ 0 | $ 27,174,589 |
| Cost of sales | 8,433,701 | 1,632,030 | 7,810,947 | 4,663,205 | 0 | 22,539,883 |
| Gross profit | 98,349 | 173,126 | 2,927,949 | 1,435,282 | 0 | 4,634,706 |
| Selling, general and administrative expenses | 1,768,710 | 247,354 | 2,862,185 | 846,891 | 438,616 | 6,163,756 |
| Operating income (loss) | $ (1,670,361) | $ (74,228) | $ 65,764 | $ 588,391 | $ (438,616) | $ (1,529,050) |
| Depreciation and amortization | $ 613,100 | $ 155,450 | $ 82,520 | $ 30,000 | $ 24,000 | $ 905,070 |
| Capital expenditures | $ 246,503 | $ 7,201 | $ 394,664 | $ (1,462) | $ 19,170 | $ 666,076 |
| Three Months Ended June 30, 2001: | | | | | | |
| Revenues | $ 10,827,616 | $ 2,863,177 | $ 9,358,479 | $ 2,632,261 | $ 0 | $ 25,681,533 |
| Cost of sales | 9,115,156 | 2,389,287 | 5,674,565 | 1,554,330 | 0 | 18,733,338 |
| Gross profit | 1,712,460 | 473,890 | 3,683,914 | 1,077,931 | 0 | 6,948,195 |
| Selling, general and administrative expenses | 1,699,800 | 418,302 | 2,525,438 | 793,843 | 1,131,773 | 6,569,156 |
| Goodwill amortization | 66,905 | 14,584 | 320,387 | 111,139 | (513,015) | 0 |
| Operating income (loss) | $ (54,245) | $ 41,004 | $ 838,089 | $ 172,949 | $ (618,758) | $ 379,039 |
| Depreciation and amortization | $ 573,126 | $ 156,722 | $ 409,886 | $ 141,139 | $ 29,680 | $ 1,280,873 |
| Capital expenditures | $ 224,523 | $ 16,755 | $ 31,181 | $ 13,246 | $ 176,128 | $ 285,705 |

</TABLE>

NOTE 7 - INCOME TAXES

Income taxes are computed based upon the estimated effective rate applicable to operating results for the full fiscal year. For the periods ended June 30, 2002 and 2001 income taxes do not bear a normal relationship to income before income taxes, primarily because income from Puerto Rico operations is taxed at rates lower than the U.S. rate.

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Statements regarding the Company's anticipated performance in future periods are forward looking and involve risks and uncertainties, including but not limited to: buying patterns of its Regional Bell Operating Customers, competitor's products, the success of its recent acquisitions, changes in tax laws, particularly in regard to taxation of its subsidiary in Puerto Rico.

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Item 2. Management's Discussion and Analysis of Financial

Condition and Results of Operations

Six Months Ended June 30, 2002 Compared to
Six Months Ended June 30, 2001

Consolidated sales increased 5% to $51,095,000. Consolidated operating income decreased from $581,000 to a loss of $878,000.

Suttle sales decreased 19% to $16,815,000. Sales to the major telephone companies (Bell South, SBC, Verizon and Qwest) decreased $4,621,000 or 38%. Sales to these customers accounted for 44% of Suttle's sales. Sales to distributors, original equipment manufacturers (OEMs), and electrical contractors decreased $1,406,000, or 21%. Sales to retail customers decreased $560,000 or 61% due to decreased sales to Radio Shack, which is Suttle's principal retail customer. Suttle's export sales, including sales to Canada, increased 194% to $1,272,000.

Suttle's sales declines are attributable to the continuing slowdown in capital spending by telecommunications industry companies and in particular the Regional Bell Operating Company (RBOC) customers. DSL (Digital Subscriber Lines) revenues decreased to $1,113,000 from $3,357,000 in the year earlier period. Revenues from CorroShield products, which are sold mainly to the major telephone companies, decreased 3%. Sales of conventional voice products declined 47%. Sales of voice products are being adversely impacted by price competition from foreign manufacturers. Suttle is implementing a strategy to utilize offshore manufacturing for data products as well as implementing a telesales group to sell voice and data products to the nation's thousands of telecom and electrical installation companies. Sales of fiber-optic connector products decreased 10%.

Suttle's gross margins decreased 66% to $1,334,000. Suttle recorded a write down of excess and slow-moving inventory in the second quarter in the amount of $1,500,000, which resulted in a 9% reduction in gross margin. Gross margin percentage declined to 8% in 2002 from 19% in 2001. The decline in gross margin was also due to price cutting to meet competition and from the effect of excess manufacturing overhead costs relative to lower volumes. Suttle's operating income decreased $2,238,000. Suttle has implemented cost reduction measures, including 15% workforce reductions at its plants in Minnesota, Puerto Rico and Costa Rica. Suttle is also beginning to utilize offshore manufacturing arrangements in the Pacific Rim to strengthen the competitive position of traditional products and the DSL line filter business.

Austin Taylor's sales decreased 36% to $3,702,000. Austin Taylor's gross margin declined 51% to $417,000. Gross margin as a percentage of sales in 2002 was 11% compared to 14% in 2001. The decline in gross margin was principally due to increased pricing competition and lower business volumes. Selling, general and administrative expenses decreased by $316,000 due to cost reduction measures implemented. Operating income decreased $89,000 to a reported loss of $49,000 in 2002.

Transition Networks / MiLAN Technology segment sales increased by 17% to $20,292,000 in the first six months of 2002 compared to $17,374,000 in the same period in 2001. Sales for this segment include a $2,920,000 contribution from MiLAN Technology, which CSI purchased substantially all the assets from Digi International on March 25, 2002. MiLAN sales since acquisition were $2,930,000. Transition Networks sales were $17,362,000 in 2002 compared to $17,374,000 in the 2001 six month period. The demand for media conversion and related products has remained strong in the first half of 2002 and is expected to remain a growth market for some time. Gross margin decreased to $6,392,000 in 2002 from $6,674,000 in 2001. Gross margin as a percentage of sales was 27% in 2002 compared to 38% in 2001. Gross margins were adversely affected by the sale of



the MiLAN acquired inventory, which had lower margins. Transition Network's gross margin for the first six months was 38% compared to 38% in 2001. Selling, general and administrative expenses increased to $5,486,000 in 2002 compared to $5,018,000 in 2001. The increase was due to planned integration expenses related to the MiLAN acquisition. Transition Networks selling, general and administrative expenses in 2002 of $5,032,000 were comparable to the 2001 amount of $5,018,000. Operating income decreased to $905,000 compared to $1,656,000 (before goodwill amortization) in 2001.

On March 25, 2002 the Company acquired substantially all the assets of MiLAN Technology from Digi International (NASDAQ: DGII) in an all cash transaction valued at approximately $8,100,000. MiLAN is a growing provider of wireless telecommunications products, LAN switches, media conversion products and print servers. The Company plans to streamline MiLAN's cost structure and consolidate certain functions with other operating business units of CSI during 2002.

Sales by JDL Technologies, Inc. increased $5,519,000 or 115%. The increase was due to sales of hardware purchases and services to plan, design, implement and manage network data systems for several large school districts. Gross margin in 2002 increased to $2,869,000 compared to $2.109,000 in 2001. Gross margin as a percentage of sales decreased to 28% from 44% in the 2001 period. Higher sales of lower margin hardware were the principal factor in a lower gross margin percentage in 2002. Selling, general and administrative expenses decreased $286,000, or 15%, due to tighter cost control efforts. JDL's operating income was $1,091,000 in 2002 compared to operating income of $483,000 (before goodwill amortization) in the 2001 period.

Consolidated investment income decreased $339,000 due to lower earnings on invested funds and collection of the balance of a note receivable and accrued interest in the first quarter related to the sale of assets of discontinued operations. Interest expense decreased by $191,000 in 2002 compared to 2001 due to a decrease in borrowings on the line of credit and a lower interest rate. Income before income taxes decreased by $1,607,000 to a loss of $897,000. The Company's effective income tax rate was (36)% compared to 26% in the first half of 2001 resulting in a refundable amount of $325,000 in 2002. The decrease in the tax rate was due to losses from operations and also from the lower amount of non-deductible goodwill amortization previously experienced. Net income decreased $1,072,000.

Three Months Ended June 30, 2002 Compared to
Three Months Ended June 30, 2001

Consolidated sales increased 6% to $27,175,000. Consolidated operating income decreased to a loss of $1,529,000.

Suttle sales decreased 21% to $8,532,000. Sales to the major telephone companies decreased $3,658,000 to $3,494,000. Sales to these customers accounted for 41% of Suttle's sales. Sales to distributors, original equipment manufacturers (OEMs), and electrical contractors increased $476,000, or 18%. Sales to retail customers decreased $312,000 or 64% due to decreased sales to Radio Shack, which is Suttle's principal retail customer. Suttle's export sales increased 22% to $262,000.

DSL revenues decreased to $586,000 from $991,000 in the year earlier period. Additional broadband products are to be released this year. Sales of Suttle's voice products (CorroShield and conventional products) declined $2,550,000 or 29%. Sales of voice products are being adversely impacted by price competition from foreign manufacturers. Sales of fiber-optic connector products decreased 12%.



Suttle's gross margins decreased 94% to $98,000. Suttle recorded a write down of excess and slowmoving inventory in the second quarter in the amount of $1,500,000, which resulted in an 18% reduction in gross margin. Beyond this the decline in gross margin was due primarily to price cutting to meet competition and excess factory overhead costs relative to lower volumes. Suttle reported an operating loss of $1,670,000 in the three-month period in 2002 compared to operating loss of $54,000 in the same period in 2001.

Austin Taylor's sales decreased 37% to $1,805,000 in the 2002 period. Austin Taylor's gross margin declined 63% to $173,000. Gross margin as a percentage of sales was 9% in 2002 compared to 17% in 2001. Selling, general and administrative expenses decreased $171,000 due to increased cost control efforts. Operating income decreased $103,000 to an operating loss of $74,000.

Transition Networks / MiLAN Technology segment sales increased by 15% to $10,739,000 in the second quarter of 2002 compared to $9,358,000 in the same period in 2001. Sales for this segment include sales from MiLAN Technology, which CSI purchased substantially all the assets from Digi International on March 25, 2002. MiLAN sales since acquisition were $2,930,000. Transition Networks second quarter sales were $8,689,000 in 2002 compared to $9,358,000 in the 2001 three-month period. Gross margin decreased to $2,928,000 in 2002 from $3,684,000 in 2001. Gross margin as a percentage of sales was 27.3% in 2002 compared to 39% in 2001. Gross margins were adversely affected by the sale of the MiLAN acquired inventory, which had lower margins. Transition Network's gross margin for second quarter was 38% compared to 39% in 2001. Selling, general and administrative expenses increased to $2,862,000 in 2002 compared to $2,525,000 in 2001. The increase was due to planned integration expenses related to the MiLAN acquisition. Transition Network's selling, general and administrative expenses in 2002 of $2,505,000 were comparable to the 2001 amount of $2,525,000. Operating income decreased to $66,000 compared to $1,158,000 (before goodwill amortization) in 2001.

Sales by JDL Technologies, Inc. increased $3,466,000 or 132%. JDL's gross margin only increased $357,000 to $1,435,000 due to increased sales of hardware and services. Gross margin as a percentage of sales decreased to 24% from 41% in the 2001 period due to increased sales of lower margin hardware and equipment. Selling, general and administrative expenses increased $53,000, or 7%. JDL's operating income was $588,000 compared to $284,000 (before goodwill amortization) in the 2001 period.

Consolidated investment income decreased $172,000 due to lower earnings on invested funds and collection of the balance of a note receivable and accrued interest in the first quarter related to the sale of assets of discontinued operations. Interest expense decreased by $102,000 in 2002 compared to 2001 due to a decrease in borrowings on the line of credit and lower interest rates. Income before income taxes decreased by $1,977,000 to a loss of $1,532,000. The Company's effective income tax rate was (32)% compared to 29% in the first half of 2001 resulting in a refundable amount of $490,000 in 2002. The decrease in the tax rate was due to losses from operations and also from the lower amount of non-deductible goodwill amortization previously experienced. Net income decreased $1,357,000.

## Liquidity and Capital Resources

At June 30, 2002, the Company had approximately $21,967,000 of cash and cash equivalents compared to $22,240,000 of cash and cash equivalents at December 31, 2001. The Company had working capital of approximately $50,590,000 and a current ratio of 3.3 to 1 compared to working capital of $51,149,000 and a current ratio of 3.4 to 1 at the end of 2001.



The Company had operating cash flows of $8,000,000 in the first six months of 2002 compared to cash flows of $7,166,000 in the same period in 2001. The Company has adjusted the business plans of all operations in order to conserve cash and reduce excess inventory and accounts receivable levels.

Investing activities used $6,298,000 of cash in the 2002 period. The Company acquired substantially all of the assets of MiLAN Technology on March 25, 2002 for approximately $8,058,000 in cash. Also in the first quarter of 2002, the Company received the balance of $2,765,000 of the note receivable related to the sale of assets of a previously discontinued business unit. Cash investments in new plant and equipment totaled $936,000, which was financed by internal cash flows. The Company expects to spend $1,500,000 on capital additions in 2002.

Net cash used in financing activities was $2,014,000 for the first six months of 2002. The Company reduced its notes payable by $2,000,000 in the second quarter of 2002. Notes payable were $7,000,000 at June 30, 2002 compared to $9,000,000 at December 31, 2001. The Company purchased and retired 2,762 shares of its stock in open market transactions during the 2002 period. At June 30, 2002 Board authorizations are outstanding to purchase an additional 225,671 shares.

In the opinion of management, based on the Company's current financial and operating position and projected future expenditures, sufficient funds are available to meet the Company's anticipated operating and capital expenditure needs.

## Critical Accounting Policies

Our critical accounting policies, including the assumptions and judgements underlying them, are discussed in our 2001 Form 10-K in Note 1 Summary of Significant Accounting Policies included in our Consolidated Financial Statements. These policies have been consistently applied in all material respects and disclose such matters as revenue recognition, investment valuation, asset impairment recognition and foreign currency translation. On an ongoing basis, we evaluate our estimates, including those related to reserves for inventory valuation, uncollectable receivables and sales returns. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the result of which form the basis for making judgements about the carrying value of assets and liabilities that are not readily apparent from other sources. Results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. Management on an ongoing basis reviews these estimates and judgements.

## Market Risk Disclosures

The Company has no freestanding or embedded derivatives. All contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as normal purchases or sales. The Company's policy is to not use freestanding derivatives and to not enter into contracts with terms that cannot be designated as normal purchases or sales.

The vast majority of our transactions are denominated in U.S. dollars; as such, fluctuations in foreign currency exchange rates have historically not been material to the Company. At June 30, 2002 our bank line of credit carried a variable interest rate based on the London Interbank Offered Rate (Libor) plus 2%. The Company's investments are money market type of investments that earn interest at prevailing market rates and as such do not have material risk exposure.

Based on the Company's operations, in the opinion of management, no material future losses or exposure exist relative to market risk.

## PART II. OTHER INFORMATION

Items 1 - 3. Not Applicable

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

The Annual Meeting of the Shareholders of the Registrant was held on May 16,2002 in Minneapolis, MN. The total number of shares outstanding and entitled to vote at the meeting was 8,261,493 of which 7,703,144 were present either in person or by proxy. Shareholders re-elected board members Edwin C. Freeman, Luella Gross Goldberg and Randall D. Sampson to three-year terms expiring at the 2005 Annual Meeting of Shareholders. The vote for these board members was as follows:

| | In Favor | Abstaining |
|---|---|---|
| Edwin C. Freeman | 7,611,491 | 91,653 |
| Luella Gross Goldberg | 7,611,290 | 91,854 |
| Randall D. Sampson | 7,599,534 | 103,609 |

Board members continuing in office are Paul J. Anderson, Wayne E. Sampson and Frederick M. Green (whose terms expire at the 2003 Annual Meeting of Shareholders) and Curtis A. Sampson and Gerald D. Pint (whose terms expire at the 2004 Annual Meeting of Shareholders).

Shareholders also approved an amendment to increase the number of shares authorized to be issued under the Company's 1990 Employee Stock Purchase Plan to increase the total number of shares authorized to be issued under such plan by 100,000 shares to 400,000 shares. The vote to approve the amendment was 7,350,149 in favor, 102,915 against and 250,077 abstaining.

Items 5 - 6. Not Applicable

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

Communications Systems, Inc.

By /s/ Paul N. Hanson

Paul N. Hanson
Vice President and
Chief Financial Officer

Date: August 14, 2002



## CERTIFICATION

The undersigned certifies pursuant to 18 U.S.C. 1350 that:

(1) The accompanying report on Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the accompanying Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By /s/ Curtis A. Sampson

Curtis A. Sampson
Chairman and
Chief Executive Officer

August 14, 2002

By /s/ Paul N. Hanson

Paul N. Hanson
Vice President and
Chief Financial Officer

August 14, 2002