UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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, 1997

OR

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

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 and zip code)

Registrant's telephone number, including area code: (320) 848-6231

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

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

Title of each class
Common Stock, $.05 par value

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 a 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 10-K or any amendment to this Form 10-K. (X)

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $127,328,000 based upon the closing sale price of the Company's common stock on the NASDAQ National Market System on March 10, 1998.

As of March 11, 1998 there were outstanding 9,349,552 shares of the Registrant's common stock.

Documents Incorporated by Reference: The Company's Proxy Statement for its Annual Meeting of Shareholders to be held on May 19, 1998 is incorporated by reference into Part III of this Form 10-K.

PART I

ITEM 1. BUSINESS

(a) GENERAL DEVELOPMENT OF BUSINESS

Communications Systems, Inc. is a Minnesota corporation organized in 1969 which, operating directly and through its subsidiaries located in New Jersey, Puerto Rico, Costa Rica and Bethesda, Wales (herein collectively called "CSI" or the "Company") is principally engaged in the manufacture and sale of modular connecting and wiring devices for voice and data communications. The Company's product line, which is commonly referred to as "telephone station apparatus", consists primarily of equipment which connects telephones, data terminals and related customer premise equipment to the telephone network.

Effective January 4, 1996, the Company acquired Automatic Tool and Connector Company, Inc. ("ATC"). ATC is a manufacturer of connecting devices for fiber optic equipment located in Union, New Jersey. The acquisition was accounted for as a purchase and operations of ATC have been included in consolidated operations from January 4, 1996. Additional information on this acquisition can be found in subparagraph (c)(1)(iii) under Item 1 herein, in "Acquisitions and Dispositions" under Item 7, Management's Discussion and Analysis and in Note 1 of Notes to Consolidated Financial Statements under Item 8, herein.

Until November, 1996, the Company conducted a value-added design and contract manufacturing operation through a subsidiary located in Merrifield, Minnesota. During 1996, the Company's Board of Directors concluded this business was no longer a strategic fit with the Company's telephone station apparatus business. Effective November 4, 1996, these operations were sold to Nortech Systems, Inc. For additional information on this divestiture, see subparagraph (c)(2) under Item 1 herein and "Acquisitions and Dispositions" under Item 7, Management's Discussion and Analysis and Note 2 of Notes to Consolidated Financial Statements under Item 8, herein.

(b) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS

The Company's continuing operations are in one business segment - the manufacture and sale of connecting and wiring devices for voice and data communications. The Company conducts manufacturing in the United States (including Puerto Rico), the United Kingdom and Costa Rica. Information regarding operations in the various geographic areas is set forth in Note 10 in the Financial Statements under Item 8 herein.

(c) NARRATIVE DESCRIPTION OF BUSINESS

(1) Telephone Station Apparatus Segment

Telephone station apparatus is manufactured and marketed under the "Suttle Apparatus" brand name in the United States (U.S.) and internationally and through Austin Taylor Communications in the United Kingdom (U.K.), Europe and other foreign countries. Fiber optic connector products are manufactured and marketed by Automatic Tool and Connector Co. in the U.S. and internationally. Suttle Apparatus sales were $58,325,000 in 1997, or 77% of consolidated revenues. Sales by Austin Taylor Communications accounted for $13,316,000 or 18% of consolidated revenues. Sales by Automatic Tool and Connector Co. were $4,091,000 or 5% of consolidated revenues.

(i) Suttle Apparatus Operations

The Company manufactures telephone station apparatus at its plants in Hector, Minnesota (Suttle Apparatus Minnesota Division), Humacao, Puerto Rico (Suttle Caribe, Inc.) and San Jose, Costa Rica (Suttle Costa Rica, S.A.). Products are marketed under the "Suttle Apparatus" brand name in the U.S. and internationally and under the "Tel Products" brand name in the U.S. retail market.

(A) Products

Suttle Apparatus' telephone station apparatus products are used in on-premise connection of telephones, data terminals and related equipment. The product line consists primarily of modular connecting devices and includes numerous types of jacks, connecting blocks and assemblies, adapters, cords and related equipment, which are offered in a variety of colors, styles and wiring configurations. Most of the Company's products are used in voice applications, but the Company continues to develop an expanding line of products for network systems applications. A significant portion of the Company's revenues are derived from sales of a line of corrosion resistant connectors which utilize a water resistant gel to offer superior performance in harsh environments. The Company's station apparatus products generally range in price from $.70 to $25.00 per unit. A majority of the sales volume, both in units and revenues, is derived from products selling for under $5.00.

(B) Markets and Marketing

The Company competes in all major segments of the telephone station apparatus market. These market segments include the "Big 6" telephone companies (the five Regional Bell Operating Companies, or "RBOCs" and GTE), other telephone companies, electrical contractors, interconnect companies, original equipment manufacturers and retailers. These markets are served directly through the Company's sales staff and through distributors such as Sprint North Supply, Graybar Electric Company, Alltel Supply, KGP and Anixter Communications.

As a group, sales to the Big 6 telephone companies, both directly and through distribution, were approximately $38,027,000 in 1997 and $34,271,000 in 1996, which represented about 65% of Suttle Apparatus' sales in each year. Sales to GTE Supply and KGP, Inc., the principal distributors serving this market, amounted to 23% and 13%, respectively, of Suttle Apparatus' sales in 1997. Sales to Sprint North Supply, another large distributor serving this market were approximately 10% of Suttle Apparatus' sales in 1996.

Approximately 10% of Suttle Apparatus' 1997 revenues were derived from sales in the retail market. The Company is a supplier of station apparatus to Radio Shack, other retailers, office supply distributors and specialized telephone stores. Sales to the retail market are made through a limited number of manufacturers' representatives.

The market for business and network systems products is the fastest growing segment of the station apparatus industry. Independent contractors (which include businesses often referred to as "interconnect companies") are engaged in the business of engineering, selling, installing and maintaining telephone equipment for the business community. The Company markets its products to independent contractors through a network of manufacturers representatives, through distribution, and through the Company's sales staff. Sales of products for business and network systems accounted for 13% of Suttle Apparatus' 1997 revenues.

The balance of Suttle Apparatus' sales in 1997 and 1996 were to original equipment manufacturers and non-Big 6 telephone companies. In the communications industry market, sales to telephone companies are made directly or through distribution. Sales to OEM customers are made through a nationwide network of distributors, some of which are affiliates of major telephone companies, and through the Company's sales staff.

(C) Competition

Suttle Apparatus encounters strong competition in all its station apparatus product lines. The Company competes primarily on the basis of the broad lines of products offered, product performance, quality, price and delivery.

The Company's principal competitors for sales to telephone companies and independent contractors include: Lucent Technologies, Ortronics, Leviton, Hubbell, Northern Telecom and AMP, Inc. Most of these companies have greater financial resources than the Company. In addition, distributors of the Company's apparatus products also market products for one or more of these competitors. Lucent Technologies markets to telephone companies and independent contractors directly and through telephone industry distributors that also market the Company's products.

In retail markets, the Company experiences significant competition from importers of low-priced modular products which market their products directly and through a number of distributors to various retail outlets.

The Company's principal competitor for sales to the Regional Bell Operating Companies is Lucent Technologies. To date, foreign manufacturers of apparatus products have not presented significant competition for sales to this market.

(D) Order Book

Suttle Apparatus manufactures its station apparatus on the basis of estimated customer requirements. Outstanding customer orders at March 1, 1998 were approximately $3,664,000 compared to approximately $4,600,000 at March 1, 1997. Because new orders are filled on a relatively short timetable, the Company does not believe its order book is a significant indicator of future results.

(E) Manufacturing and Sources of Supply

The Company's station apparatus products are manufactured using plastic parts, wire sub-assemblies, fasteners, brackets, electronic circuit boards and other components, most of which are fabricated by the Company. There are multiple sources of supply for the materials and parts required and the Company is not dependent upon any single supplier, except that Suttle's corrosion resistant products utilize a moisture-resistant gel-filled fig available only from Raychem Corporation. The unavailability of the gel-filled figs from Raychem Corporation could have a material adverse effect on the Company. The Company has not generally experienced significant problems in obtaining its required supplies, although from time to time spot shortages are experienced.

(F) Research and Development; Patents

The Company continually monitors industry requirements and creates new products to improve its existing station apparatus product line. The Company's CorroShield line of corrosion resistant products was introduced in 1993, as was the Flex-Plate line of data products. The Company added additional products to these product lines in 1994 and 1995. The Company's new SpeedStar line of high speed data connectors was introduced in early 1996. In 1997, a proprietary Category 5 connector was developed which meets the highest current industry standard.

Historically, the Company has not relied on patents to protect its competitive position in the station apparatus market. However, duplication of Company designs by foreign apparatus manufacturers has caused the Company to apply for design patents on a number of station apparatus products.

The Company's "Suttle Apparatus" brand name is important to its business. The Company regularly supports this name by trade advertising and believes it is well known in the marketplace.

(ii) Austin Taylor Operations

Austin Taylor Communications, Ltd. manufactures voice and data connectors and related products at its plant in Bethesda, Wales, U.K. Its product line consists of British standard line jacks, patch panels, wiring harness assemblies, metal boxes, distribution cabinets and distribution and central office frames.

Austin Taylor is a vertically integrated manufacturer with metal stamping, metal bending, forming and painting, plastic injection molding and printed circuit board assembly capabilities. Austin Taylor's major customers include Cable and Wireless Communications, Northern Telecom Europe, Lucent Technologies and British Telecom. Austin Taylor's products are sold directly by its sales staff and through distributors, including Anixter Communications, NS Supply Group, RS Components and Telcom Products. Approximately 78% and 76% of Austin Taylor sales were to United Kingdom customers in 1997 and 1996, respectively.

The Company believes the European telecommunications market will offer increasing opportunities as the European Economic Community eliminates trade barriers and standardizes on modular connector products. In addition to continued manufacturing and marketing of its existing products, Austin Taylor will be a base to manufacture and/or distribute existing Suttle Apparatus products or new jointly developed products in the United Kingdom, Europe and internationally. The Company also markets Austin Taylor products in the U.S., Canada, and other markets.

Outstanding customer orders for Austin Taylor products were approximately $754,000 at March 1, 1998 compared to $1,531,000 at March 1, 1997. Because Austin Taylor fills new orders on a relatively short time table, the Company does not believe its order book is a significant indicator of future results.

(iii) Automatic Tool and Connector Company Operations

Effective January 4, 1996, by its acquisition of Automatic Tool and Connector Company ("ATC"), the Company entered the rapidly growing market for fiber optic connector products. Located in Elizabeth, New Jersey, ATC manufactures a line of high performance fiber optic connectors, interconnect devices and fiber cable assemblies for the telecommunications, computer and electronics markets. ATC's patented Quick Term TM fiber optic connector significantly reduces installation time and costs associated with making fiber connections. By eliminating the need for a curing oven, the product reduces field installation time for this process from 20 minutes to 2 minutes.

ATC markets its products to original equipment manufacturers (OEMs) in the U.S. and internationally through the Company's sales staff and a network of distributors and manufacturers representatives, including Graybar Electric Company, Arcade Electronics and Primestock. Export sales of ATC products were $538,000 in 1997 accounting for 13% of ATC's sales.

Outstanding customer orders for ATC's products were approximately $197,000 at March 1, 1998 compared to $80,000 at March 1, 1997. Because ATC fills new orders on a relatively short time table, the Company does not believe its order book is a significant indicator of future results.

(2) Discontinued Contract Manufacturing Operations

Prior to November, 1996, the Company, through its subsidiary, Zercom Corporation, engaged in contract manufacturing of electronic assemblies and products, including printed circuit board assembly, cable and harness assembly and electro-mechanical assemblies, for original equipment manufacturers (OEMs). Zercom also provided product engineering services, including circuit board design, case and enclosure design and product development consulting from design concept to finished product and manufactured electronic fishing products for the sports fishing market.

During the third quarter of 1996, the Company's Board of Directors concluded that the contract manufacturing business was no longer a strategic fit with the Company's plans for its domestic and international telecommunications manufacturing business. After considering various alternatives for the disposition of Zercom, the Company agreed to sell the assets (except cash and accounts receivable) of Zercom Corporation to Nortech Systems, Inc. . (Nasdaq National Market System: NSYS) effective November 4, 1996.

(3) Employment Levels

As of March 1, 1998 the Company employed 950 people. Of this number, 936 were engaged in telephone equipment manufacturing operations (including 224 in Puerto Rico, 179 in Hector, Minnesota, 37 in Elizabeth, New Jersey, 319 in Costa Rica and 177 in Wales) and 14 held general and administrative positions. The Company considers its employee relations to be good.

(4) Factors Affecting Future Performance

From time to time, in reports filed with the Securities and Exchange Commission, in press releases, and in other communications to shareholders or the investing public, the Company may comment on anticipated future financial performance. Such forward looking statements are subject to risks and uncertainties, including but not limited to buying patterns of Bell Operating Companies, the impact of new products introduced by competitors, higher than expected expenses related to sales and new marketing initiatives, changes in tax laws, particularly in regard to taxation of income of its subsidiary in Puerto Rico and other risks involving the telecommunications industry generally.

(5) Executive Officers of Registrant

The executive officers of the Company and their ages at March 1, 1998 were as follows:

Name	Age	Position (1)
Curtis A. Sampson	64	Chairman of the Board, President and Chief Executive Officer [1970]
Jeffrey K. Berg	55	President and General Manager Suttle Apparatus Corporation [1990]
Paul N. Hanson	51	Vice President - Finance, Treasurer and Chief Financial Officer [1982]
John C. Hudson	53	Managing Director, Austin Taylor Communications, Ltd. [1992]

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(1) Dates in brackets indicate period during which officers began serving in such capacity. Executive officers serve at the pleasure of the Board of Directors and are elected annually for one year terms.

Messrs. Sampson and Hanson each devote approximately 60% of their working time to the Company's business with the balance devoted to management responsibilities at Hector Communications Corporation ("HCC"), a diversified telecommunications holding company also headquartered in Hector, Minnesota, for which they are separately compensated by HCC.

(d) FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

Financial information about domestic and foreign operations and export sales may be obtained by reference to Note 10 of the "Notes to Consolidated Financial Statements" under Item 8 herein.

ITEM 2. PROPERTIES

The administrative and manufacturing functions of CSI are conducted at the following facilities:

- -- In Hector, Minnesota the Company owns a 15,000 square foot building where its executive and administrative offices are located.

- -- Telephone station apparatus manufacturing is conducted at four locations. At Hector, Minnesota, the Company owns three plants totaling 68,000 feet of manufacturing space. Austin Taylor Communications, Ltd. owns a 40,000 square foot facility and leases a 6,000 square foot facility in Bethesda, Wales. The Company has a long-term lease from the Puerto Rico Industrial Development Company on three facilities in Humacao, Puerto Rico aggregating 65,000 square feet. The Company also has leased 40,000 square feet of manufacturing space in San Jose, Costa Rica.

- -- The Company leases a 5,000 square foot facility in Elizabeth, New Jersey where Automatic Tool and Connector Company manufactures its fiber optic connector products.

- -- The Company owns a 35,000 square foot plant in Lawrenceville, Illinois. This facility is for sale, but is currently leased to other tenants, pending a sale.

CSI believes these facilities will be adequate to accommodate its administrative and manufacturing needs for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

No material litigation or other claims are presently pending against the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET MATTERS FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(a) MARKET INFORMATION

The Company's common stock is currently traded in the National Market System of the National Association of Securities Dealers Automated Quotation System ("NASDAQ").

The table below presents the price range of high and low trades of the Company's common stock for each period indicated as reported by NASDAQ:

	1997		1996	
	High	Low	High	Low
First	$15.13	$13.50	$16.25	$13.25
Second	15.00	12.50	16.50	12.75
Third	22.63	14.00	15.88	11.25
Fourth	22.75	16.00	16.00	12.50

(b) HOLDERS

At March 1, 1998 there were approximately 785 holders of record of Communications Systems, Inc. common stock.

(c) DIVIDENDS

The Company has paid regular quarterly dividends since October 1, 1985. The per share quarterly dividends payable in fiscal 1996 and 1997 were as follows:

January 1, 1996 - April, 1996	$.07
July 1, 1996 - April, 1997	.08
July 1, 1997 - Present	.09

ITEM 6. SELECTED FINANCIAL DATA

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
SELECTED FINANCIAL INFORMATION
(in thousands except per share amounts)

	Year Ended December 31				
	1997	1996	1995	1994	1993

Selected Income Statement Data

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Revenues From Continuing Operations	$ 75,732	$ 68,705	$ 66,004	$ 57,077	$ 47,896
Costs and Expenses:					
Cost of Sales	52,302	47,719	47,297	40,812	33,348
Selling, General and Administrative Expenses	10,947	10,581	8,519	8,180	7,126
Total Costs and Expenses	63,249	58,300	55,816	48,992	40,474
Operating Income From Continuing Operations	12,483	10,405	10,189	8,086	7,422
Other Income, Net	1,654	799	899	341	567
Income From Continuing Operations Before Income Taxes	14,137	11,204	11,088	8,427	7,988
Income Tax Expense	3,200	2,250	2,164	1,616	1,308
Income From Continuing Operations	10,937	8,954	8,924	6,811	6,680
Income (Loss) From Discontinued Operations, Net of Taxes		(721)	160	(7)	55
Net Income	$ 10,937	$ 8,233	$ 9,084	$ 6,804	$ 6,735
Basic Net Income (Loss) Per Common Share:					
Continuing Operations	$ 1.18	$ .97	$ .98	$ .76	$ .75
Discontinued Operations		(.08)	.02	.01	
Basic Net Income Per Share	$ 1.18	$ .89	$ 1.00	$ .76	$ .76
Diluted Net Income (Loss) Per Common Share					
Continuing Operations	$ 1.17	$ .96	$ .97	$ .75	$ .74
Discontinued Operations		(.08)	.02	.01	
Diluted Net Income Per Share	$ 1.17	$ .88	$ .99	$ .75	$ .75
Cash Dividends Per Share	$ .34	$ .30	$ .26	$ .22	$ .19
Average Common and Potential Common Shares Outstanding	9,325	9,352	9,217	9,093	9,026

Selected Balance Sheet Data

Total Assets	$ 77,518	$ 67,596	$ 61,945	$ 54,799	$ 46,105
Property, Plant and Equipment, Net	9,675	8,965	8,658	8,132	5,883
Working Capital	48,514	35,906	29,039	22,420	20,283
Net Assets of Discontinued Operations		537	9,255	8,033	5,218
Assets of Businesses Transferred Under Contractual Arrangements					

				593	1,001
Stockholders' Equity	69,264	59,015	54,076	45,566	40,365

</TABLE>

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

1997 Compared to 1996

Sales increased 10% to $75,732,000. Operating income increased 20% to $12,483,000. Sales to customers in the United States (U.S.) increased 10% to $59,674,000. Sales to the Big 6 telephone companies (the five Regional Bell Operating Companies (RBOCs) and GTE) increased 11% to $38,027,000, accounting for 64% of U.S. customer sales. Sales to distributors, original equipment manufacturers (OEMs), and electrical contractors increased 8%. Sales to retail customers increased 11% due to increased sales to Radio Shack. U.S. export sales, including sales to Canada decreased 9% to $2,741,000.

The sales increases were generated by a 56% increase in sales of the Company's CorroShield line of corrosion resistant connectors. CorroShield product sales totaled $23,610,000 in 1997 compared to $15,123,000 in 1996. During 1997, two additional RBOCs converted to this product line for the majority of their residential installations. This product conversion resulted in an 11% decline in sales of conventional voice connecting products in 1997, a trend the Company expects to continue. Sales of data products increased 8% to $7,314,000. Sales of fiber optic connector products decreased 15% to $4,091,000.

Sales by Austin Taylor Communications, Ltd., the Company's United Kingdom (U.K.) based subsidiary increased 18% to $13,316,000. Growth was due to increased sales of network termination equipment and street cabinets to U.K. cable television companies and increased sales of plastic and metal distribution boxes through the distributor market.

Gross margins on sales increased 12% to $23,430,000. Gross margin as a percentage of sales was 31%, unchanged from 1996. Gross margin in U.S. plants was 34% compared to 33% in 1996. Improvement in gross margin was due to lower purchase costs for certain raw materials and improved manufacturing overhead efficiencies due to increased production volumes. Margins on Austin Taylor products were 18% compared to 19% in 1996. The decline in margins was due to product development costs and increased costs for certain raw materials.

Selling, general and administrative expenses increased $366,000 or 3%. The increase was due to increased sales expenses associated with efforts to increase sales of the Company's data products and develop export markets for U.S. apparatus products. These U.S. sales expense increases more than offset lower sales expenses at Austin Taylor and lower corporate expenses.

Investment income, net of interest expense, increased $855,000 due to increased levels of funds available for investment and interest on notes receivable from the sale of discontinued operations.

Income from continuing operations before income taxes increased $2,933,000 or 26%. The Company's effective income tax rate was 22.6% compared to 20.1% in 1996. The increase in the tax rate was due to increased U.S. taxes on the Company's earnings in Puerto Rico. Income from continuing operations increased $1,983,000 or 22%.

1996 Compared to 1995

Revenues from continuing operations increased 4% to $68,705,000. Operating income from continuing operations increased 2% to $10,405,000. Sales to customers in the United States (U.S.) increased 11% to $54,421,000. Sales to the Big 6 telephone companies increased 9% and accounted for 63% of U.S. apparatus sales. Sales to distributors, original equipment manufacturers (OEMs), and electrical contractors increased 29%. The sales increases were generated by increased sales of the Company's CorroShield line of corrosion resistant connectors and by sales of the fiber optic connector products acquired in the January, 1996 purchase of Automatic Tool and Connector Company, Inc. CorroShield sales increased 3% to $15,123,000 in 1996, accounting for 28% of all U.S. shipments. Sales of data products increased 9% to $6,746,000 and accounted for 12% of U.S. shipments. Sales to retail customers decreased 8% primarily due to loss of the Company's sales contract with Coast-to-Coast stores. Sales to international customers from the Company's U.S. plants, including sales to Canada, decreased 1% to $3,020,000 as sales of fiber optic products offset lower station apparatus sales.

Sales by Austin Taylor, the Company's United Kingdom based subsidiary, decreased $2,490,000, or 18%. The sales decrease was due to the loss to competitors of a number of sales contracts with British Telecom for line jacks and modular boxes. Shipments of new products to the U.K. cable television industry were delayed due to slower than anticipated contract start-ups. Sales of these products did not reach expected volumes until later in 1996. Sales to U.K. customers accounted for 76% of Austin Taylor's 1996 sales.

Gross margins on sales were $20,986,000 in 1996, up 12% from $18,707,000 in 1995. Gross margin as a percentage of sales was 31% compared to 28% in 1995. Gross margin in U.S. plants was 33% compared to 29% in 1995. Improvement in gross margin was due to lower purchase costs for certain raw materials and changes in product mix, emphasizing sales of higher margin CorroShield and fiber optic connector products. Austin Taylor's margins declined to 19% from 24% in 1995 due to increased product development costs and unfavorable overhead costs associated with reduced sales volumes.

Selling, general and administrative expenses increased $2,063,000 or 24%. The increase was principally due to selling, administration and amortization costs associated with the Company's new Automatic Tool and Connector Co. subsidiary. U.S. apparatus selling and administrative expenses, exclusive of the effect of the Automatic Tool acquisition, increased $561,000 or 11% due to increased international sales expenses. General corporate expenses increased $220,000 or 23% due to increased reserves in the company group medical program.

Investment income, net of interest expense, decreased $100,000 due to decreased marketable securities valuations.

Income from continuing operations before income taxes increased $116,000 or 1%. The Company's effective income tax rate was 20.1% compared to 19.5% in 1995. The increase in the tax rate was due to increased U.S. taxes on the Company's earnings in Puerto Rico. Income from continuing operations increased $30,000.

Acquisitions and Dispositions

Effective January 4, 1996, the Company acquired Automatic Tool and Connector Co., Inc. ("ATC") of Union, New Jersey, in exchange for $3,191,000, consisting of $1,473,000 of cash and 112,676 shares of the Company's common stock. ATC is a manufacturer of high performance fiber optic connectors, interconnect devices and coaxial cable assemblies for the telecommunications, medical electronics, computer and other markets. The acquisition represents the Company's entry into the market for fiber optic connectors, which is the fastest growing segment in the telecommunications connector market. Sales of fiber optic products were $4,091,000 and $4,789,000 in 1997 and 1996, respectively. The decrease in sales was due to loss of the business of a major OEM customer who is also a competitor of Suttle Apparatus and design and production problems with the Company's Quick Term TM fiber optic connector product. The Company has upgraded this product for 1998 to address these problems. ATC's operating income was $30,000 and $129,000 in 1997 and 1996, respectively.

During the third quarter of 1996, the Company's Board of Directors concluded that the contract manufacturing business was no longer a strategic fit with the Company's plans for its domestic and international telecommunications manufacturing business. After considering various alternatives for the disposition of Zercom, the Company agreed to sell the assets (except cash and accounts receivable) of Zercom Corporation to Nortech Systems, Inc. for $1,500,000 of cash and a $4,867,000 five-year note. The transaction was completed November 4, 1996.

Revenue from discontinued operations was $13,518,000 in 1996. Loss from operations, net of income tax benefits, was $719,000. The loss was principally due to write-downs against slow-moving electronic fishing products inventory. Loss on disposal of the business, after income taxes, was $2,000.

The acquisitions the Company has made over the past several years have served to expand the Company's product offerings and customer base in both U.S. and international markets. The Company is a growth oriented manufacturer of telecommunications connecting devices. The Company is continuing to search for acquisition candidates with products that will enable the Company to better serve its target markets.

Effects of Inflation

Inflation has not had a significant effect on operations. The Company does not have long-term production or procurement contracts and has historically been able to adjust pricing and purchasing decisions to respond to inflationary pressures.

Year 2000 Issues

The Company's U.S. accounting and management control systems are Year 2000 compliant. Austin Taylor's facilities are not currently Year 2000 compliant, and will be upgraded in the third quarter of 1998. The Company has also been in contact with its major customers and suppliers to ensure that Year 2000 issues do not cause any unforseen electronic data interchange or other problems. Year 2000 issues are not expected to have a material effect on the Company's operations or financial results.

Liquidity and Capital Resources

At December 31, 1997, the Company had approximately $23,192,000 of cash, cash equivalents and short-term U.S. Treasury investments compared to $17,799,000 of cash and cash equivalents at December 31, 1996. The Company had working capital of approximately $48,514,000 and a current ratio of 6.9 to 1 compared to working capital of $35,906,000 and a current ratio of 5.2 to 1 at the end of 1996.

Cash flow provided by operations was approximately $7,545,000 in 1997 compared to $10,572,000 in 1996. The decrease was due to the increased inventory and accounts receivable levels caused by the Company's increased levels of business. Investing activities utilized $6,435,000 in cash in 1997. Cash investments in U.S. Treasury bills and new plant and equipment in 1997 were $5,249,000 and $2,878,000, respectively. Capital additions were primarily related to improvements to manufacturing facilities in Minnesota and Costa Rica. The Company expects to spend $2,500,000 on capital additions in 1998.

Net cash used in financing activities decreased to $891,000. Proceeds from common stock issuances, principally exercises of key employee stock options, offset an increase in the Company's common stock dividend. In 1996, the Company purchased and retired 255,495 common shares under an authorization by the Board of Directors, at a cost of $3,263,000. The Company did not purchase any Company stock in 1997. However, the Company does intend to purchase and retire additional shares in 1998 if warranted by market conditions and the Company's financial position.

The bulk of the Company's U.S. apparatus manufacturing operations are located in Puerto Rico. Until 1994, substantially all the earnings of the Puerto Rico operations were sheltered from U.S. income tax due to the possessions tax credit (Internal Revenue Code Section 936). Under provisions of the Omnibus Budget Act of 1993, which went into effect beginning in the 1994 tax year, the amount of the possessions credit is limited to a percentage of the Company's Puerto Rico payroll and depreciation. U.S. income tax expense on the Company's earnings in Puerto Rico, after full utilization of the available tax credits, was $791,000, $352,000 and $272,000 in 1997, 1996 and 1995, respectively.

Under provisions of the Small Business Job Protection Act of 1996, the possessions tax credit was repealed for years after 1995. However, companies like CSI which currently qualify for the credit, may continue to claim the credit until 2005, subject to certain limitations. As of July 1, 1996, the credit no longer applies to investment income earned in Puerto Rico. The credit will continue to apply to business income earned in Puerto Rico through 2001. For the years 2002 to 2005, the amount of Puerto Rico business income eligible for the credit will be limited to an inflation adjusted amount based on Puerto Rico business income earned from 1990 to 1994. The possessions tax credit has a materially favorable effect on the Company's income tax expense. Had the Company incurred income tax expense on Puerto Rico operations in 1997 at the full U.S. rate, income tax expense would have increased by $1,987,000.

At December 31, 1997 approximately $35,032,000, $8,782,000 and $1,545,000 of assets were invested in the Company's subsidiaries in Puerto Rico, the United Kingdom and Costa Rica, respectively. The Company expects to maintain these investments to support the continued operation of the subsidiaries. The Company uses the U.S. dollar as its functional currency in Costa Rica. The United Kingdom is a politically and economically stable country. Accordingly, the Company believes its risk of material loss due to adjustments in foreign currency markets to be small.

At December 31, 1997, the Company had no outstanding obligations for notes payable or long-term debt. The Company has a $2,000,000 bank line of credit available for use. 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.

Changes in Accounting Standards

Effective December 15, 1997, the Company adopted the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share". The Statement requires the Company to present its net income per share in basic and diluted forms and to restate net income per share for prior periods to conform with the new statement. Basic net income per common share is based on the weighted average number of common shares outstanding during each year. Diluted net 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. Adoption of the new standard did not have a material effect on the Company's net income per share.

The Financial Accounting Standards Board ("FASB") has issued SFAS No. 130, "Reporting Comprehensive Income". This statement establishes standards for reporting and presenting comprehensive income and its components in the financial statements. SFAS No. 130 is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required. Adoption of this standard will have no material effect on the Company's results of operations or financial position.

The FASB has also issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". This statement establishes standards for the way public enterprises report information about operating segments in annual financial statements and requires those enterprises to report selected information about operating segments in interim financial reports to shareholders. It also establishes standards for related disclosures about products and services, geographic areas and major customers. SFAS No. 131 is effective for fiscal years beginning after December 15, 1997. Financial statement disclosures from prior periods are required to be restated. Adoption of this standard will have no material effect on the Company's results of operations or financial position.

REPORT OF MANAGEMENT

The management of Communications Systems, Inc. and its subsidiary companies is responsible for the integrity and objectivity of the financial statements and other financial information contained in the annual report. The financial statements and related information were prepared in accordance with generally accepted accounting principles and include amounts that are based on management's informed judgments and estimates.

In fulfilling its responsibilities for the integrity of financial information, management maintains accounting systems and related controls. These controls provide reasonable assurance, at appropriate costs, that assets are safeguarded against losses and that financial records are reliable for use in preparing financial statements. Management recognizes its responsibility for conducting the Company's affairs according to the highest standards of personal and corporate conduct.

The Audit Committee of the Board of Directors, comprised solely of outside directors, meets with the independent auditors and management periodically to review accounting, auditing, financial reporting and internal control matters. The independent auditors have free access to this committee, without management present to discuss the results of their audit work and their opinion on the adequacy of internal financial controls and the quality of financial reporting.

/s/ Curtis A. Sampson

Curtis A. Sampson
President and Chief Executive Officer

/s/ Paul N. Hanson

Paul N. Hanson
Chief Financial Officer

March 27, 1998

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

(a) FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

Shareholders and Board of Directors
Communications Systems, Inc.

We have audited the accompanying consolidated balance sheets of Communications Systems, Inc. and its subsidiaries (the Company) as of December 31, 1997 and 1996 and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1997. Our audits also include the financial statement schedule listed in the Index at Item 14. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 1997 and 1996 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles. Also, in our opinion, the financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Deloitte & Touche LLP
- --------------------------
Deloitte & Touche LLP
February 20, 1998
Minneapolis, Minnesota

<TABLE>
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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

<S> <C> <C>

	December 31	
	1997	1996
CURRENT ASSETS:		
Cash and cash equivalents	$ 17,942,315	$ 17,799,398
Investments in U.S. Treasury securities (Note 3)	5,249,314	
Marketable equity securities (Note 3)	802,045	889,782
Trade accounts receivable, less allowance for doubtful accounts of $796,000 and $306,000 respectively	12,571,511	10,682,546
Inventories (Note 4)	18,438,531	13,861,914
Prepaid expenses	684,221	460,692
Deferred income taxes (Note 9)	1,080,000	792,000
TOTAL CURRENT ASSETS	56,767,937	44,486,332
PROPERTY, PLANT AND EQUIPMENT,net (Notes 1 and 5)	9,674,861	8,964,590
NET ASSETS OF DISCONTINUED OPERATIONS (Note 2)		536,679
OTHER ASSETS:		
Excess of cost over net assets acquired (Note 1)	2,881,544	3,166,422
Investments in mortgage backed and other securities (Notes 1 and 3)	3,356,568	4,487,934
Note receivable from sale of assets of discontinued contract manufacturing operations (Note 2)	4,557,767	4,866,597
Deferred income taxes (Note 9)	114,047	835,047
Other assets	165,204	252,513
TOTAL OTHER ASSETS	11,075,130	

	1997	1996
	13,608,513	
TOTAL ASSETS	$ 77,517,928	$ 67,596,114

LIABILITIES AND STOCKHOLDERS' EQUITY

	1997	1996
CURRENT LIABILITIES:		
Accounts payable	$ 2,770,628	$ 3,164,406
Accrued expenses	3,030,736	2,622,853
Dividends payable	839,399	728,585
Income taxes payable	1,613,469	2,064,792
TOTAL CURRENT LIABILITIES	8,254,232	8,580,636
LEASE COMMITMENTS (Note 7)		
STOCKHOLDERS' EQUITY:		
Preferred stock, par value $1.00 per share; 3,000,000 shares authorized; none issued		
Common stock, par value $.05 per share; 30,000,000 shares authorozed; 9,326,652 and 9,107,309 shares issued and outstanding, respectively (Notes 1 and 8)	466,333	455,365
Additional paid-in capital	24,132,771	21,454,353
Retained earnings	44,552,855	36,856,285
Cumulative translation adjustments (Note 1)	111,737	249,475
TOTAL STOCKHOLDERS' EQUITY	69,263,696	59,015,478
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 77,517,928	$ 67,596,114

See notes to consolidated financial statements.
</TABLE>

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31		
	1997	1996	1995
<S>	<C>	<C>	<C>
REVENUES FROM CONTINUING OPERATIONS (Note 10):	$ 75,731,651	$ 68,704,940	$ 66,004,316
COSTS AND EXPENSES:			
Cost of sales	52,301,671	47,718,676	47,297,078
Selling, general and administrative expenses	10,947,163	10,581,557	8,518,644
TOTAL COSTS AND EXPENSES	63,248,834	58,300,233	55,815,722
OPERATING INCOME FROM ~ CONTINUING OPERATIONS	12,482,817	10,404,707	10,188,594
OTHER INCOME (EXPENSE):			
Investment income	1,690,223	808,287	917,037

Interest expense	(36,167)	(9,139)	(17,806)
OTHER INCOME, net	1,654,056	799,148	899,231
INCOME FROM CONTINUING OPERATIONS ~ BEFORE INCOME TAXES	14,136,873	11,203,855	11,087,825
INCOME TAX EXPENSE (Note 9)	3,200,000	2,250,000	2,164,000
INCOME FROM CONTINUING OPERATIONS	10,936,873	8,953,855	8,923,825
DISCONTINUED OPERATIONS (Note 2):			
Income (loss) from operations of discontinued contract manufacturing operations, net of income taxes		(719,218)	160,328
Loss on disposal of assets of contract ~ manufactuing operations, net of income taxes		(2,106)	
NET INCOME	$ 10,936,873	$ 8,232,531	$ 9,084,153
BASIC NET INCOME ~ PER COMMON SHARE (Note 1):			
Continuing Operations	$ 1.18	$ .97	$ .98
Discontinued Operations	-	(.08)	.02
	$ 1.18	$ .89	$ 1.00
DILUTED NET INCOME ~ PER COMMON SHARE (Note 1):			
Continuing Operations	$ 1.17	$ .96	$ .97
Discontinued Operations	-	(.08)	.02
	$ 1.17	$ .88	$ .99
AVERAGE SHARES OUTSTANDING:			
Weighted average number of common shares outstanding	9,231,858	9,272,825	9,097,771
Dilutive effect of stock options outstanding after application of treasury stock method	92,853	78,915	119,450
	9,324,711	9,351,740	9,217,221

See notes to consolidated financial statements.

</TABLE>

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

	Common Stock		Additional	Retained	Advances to Employee	Cumulative	
	Shares	Amount	Paid-in Capital	Earnings	Stock Owner-ship Plan	Translation Adjustment	Total
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
BALANCE AT DECEMBER 31, 1994	8,986,523	$ 449,326	$18,001,322	$27,519,954	$ (72,000)	$ (332,161)	$45,566,441
Net income				9,084,153			9,084,153
Issuance of common stock under Employee Stock Purchase Plan	23,567	1,178	193,957				195,135
Issuance of common stock under Employee Stock Option Plan	173,311	8,666	1,267,846				

							1,276,512
Tax benefit from non qualified employee stock options			243,000				243,000
Shareholder dividends				(2,463,672)			(2,463,672)
Repayment of advances to Emplo Stock Ownership Plan					72,000		72,000
Issuance of common stock to Welsh Development Agency	20,142	1,007	219,325				220,332
Purchase of Communications Systems, Inc. common stock	(20,142)	(1,007)	(219,325)				(220,332)
Foreign currency translation adjustment						102,007	102,007
BALANCE AT DECEMBER 31, 1995	9,183,401	459,170	19,706,125	34,140,435	-	(230,154)	54,075,576
Net income				8,232,531			8,232,531
Issuance of common stock to acquire Automatic Tool and Connector Co.	112,676	5,634	1,712,675				1,718,309
Issuance of common stock under Employee Stock Purchase Plan	14,346	717	157,806				158,523
Issuance of common stock under Employee Stock Option Plan	52,381	2,619	466,427				469,046
Tax benefit from non qualified employee stock options			12,701				12,701
Shareholder dividends				(2,868,154)			(2,868,154)
Purchase of Communications Systems, Inc. common stock	(255,495)	(12,775)	(601,381)	(2,648,527)			(3,262,683)
Foreign currency translation adjustment						479,629	479,629
BALANCE AT DECEMBER 31, 1996	9,107,309	455,365	1,454,353	36,856,285	-	249,475	59,015,478
Net income				10,936,873			10,936,873
Issuance of common stock to Employee Stock Ownership Plan	20,870	1,044	298,956				300,000
Issuance of common stock under Employee Stock Purchase Plan	16,622	831	182,843				183,674
Issuance of common stock under Employee Stock Option Plan	181,851	9,093	2,045,715				2,054,808
Tax benefit from non qualified employee stock options			150,904				150,904
Shareholder dividends				(3,240,303)			(3,240,303)
Foreign currency translation adjustment						(137,738)	(137,738)
BALANCE AT DECEMBER 31, 1997	9,326,652	$ 466,333	$24,132,771	$44,552,855	$ -	$ 111,737	$69,263,696

See notes to consolidated financial statements.

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

	Year Ended December 31		
	1997	1996	1995
CASH FLOWS FROM OPERATING ACTIVITIES:			
<S>	<C>	<C>	<C>
Net income	$ 10,936,873	$ 8,232,531	$ 9,084,153
Discontinued operations		721,324	(160,328)
Income from continuing operations	10,936,873	8,953,855	8,923,825
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	2,471,510	2,303,303	1,995,352
Deferred taxes	702,713	(405,880)	(22,000)
Loss on liquidation of foreign subsidiary	73,696		
Adjustment to marketable securities reserve	(40,404)	9,687	(90,046)
Changes in assets and liabilities net of effects from acquisitions and discontinued operations:			
Decrease in marketable securities	128,141		81,001
Decrease (increase) in accounts receivable	(1,966,519)	(1,483,853)	1,603,613
Decrease (increase) in inventory	(4,634,744)	1,565,972	(4,240,940)
Decrease (increase) in prepaid expenses	(225,284)	(99,921)	97,456
Decrease in accounts payable	(328,639)	(925,127)	(503,139)
Increase (decrease) in accrued expenses	727,787	617,793	(479,097)
Increase (decrease) in income taxes payable	(300,273)	36,534	(452,939)
Total adjustments	(3,392,016)	1,618,508	(2,010,739)
Net cash provided by operating activities	7,544,857	10,572,363	6,913,086
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(2,878,073)	(1,989,053)	(2,496,488)
Maturities (purchases) of mortgage backed and other investment securities	1,131,366	909,598	(87,181)
Purchase of U.S. Treasury bill investments	(5,249,314)		
Sales (purchases) of other assets	64,293	218,630	(150,475)
Collections from businesses transferred under contractual arrangements			564,657
Cash receipts from sale of assets of discontinued operations	308,830	1,500,000	
Changes in assets and liabilities of discontinued operations	267,679	1,630,416	(1,062,021)
Payment for purchase of Austin Taylor Communications, Ltd.,	(79,947)	(135,131)	
Payment for purchase of Automatic Tool and Connector Co., Inc., net of cash acquired		(1,273,776)	
Net cash provided by (used in) investing activities	(6,435,166)	860,684	(3,231,508)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayment of notes payable and long-term debt		(65,557)	(152,508)
Dividends paid	(3,129,489)	(2,782,407)	(2,360,025)
Proceeds from issuance of common stock	2,238,482	640,270	1,934,979
Purchase of Communications Systems, Inc. common stock		(3,262,683)	(220,332)
Repayments from Employee Stock Ownership Plan			

	1997	1996	1995
			72,000
Net cash used in financing activities	(891,007)	(5,470,377)	(725,886)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	(75,767)	133,192	1,774
NET INCREASE IN CASH AND CASH EQUIVALENTS	142,917	6,095,862	2,957,466
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	17,799,398	11,703,536	8,746,070
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 17,942,315	$ 17,799,398	$ 11,703,536
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Income taxes paid	$ 2,797,237	$ 2,137,401	$ 2,664,962
Interest paid	13,723	9,139	17,806

See notes to consolidated financial statements.

</TABLE>

COMMUNICATIONS SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 1997, 1996 and 1995

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of business: The Company is principally engaged in the manufacture and sale of modular connecting and wiring devices for voice and data communications. The Company's product line, which is commonly referred to as "telephone station apparatus", consists primarily of equipment which connects telephones, data terminals and related equipment at customer premises to the telephone network. The Company sells these products to telephone companies, electrical contractors, interconnect companies, original equipment manufacturers and retailers. The Company's operations are located in the United States, United Kingdom, Puerto Rico, and Costa Rica. Discontinued operations represent the Company's contract manufacturing operations, which were sold in November, 1996.

Principles of consolidation: The consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany transactions and accounts have been eliminated.

Use of estimates: The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's estimates consist principally of reserves for doubtful accounts and inventory obsolescence.

Cash equivalents: For purposes of the consolidated statements of cash flows, the Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

Acquisition of Automatic Tool and Connector Co., Inc.: Effective January 4, 1996, the Company purchased all the capital stock of Automatic Tool and Connector Co., Inc. (ATC) for $3,191,000, consisting of $1,473,000 of cash and 112,676 shares of the Company's common stock. The fair value of assets acquired in the transaction was $4,063,000 (which includes excess of cost over net assets acquired of $2,864,000) and liabilities of $872,000 were assumed.

Subsequent to the acquisition, the Company leased, with option the to purchase, the building housing ATC's manufacturing and sales operations from ATC's former owners. Payments under the lease were $143,700 and $129,600 in 1997 and 1996 respectively, which the Company believes to be the building's fair market rental. The lease expired December 31, 1997. At the expiration of the lease, the Company declined to exercise its purchase option on the building and moved to a different location. As required by the purchase agreement, the Company then made an additional payment of $100,000 to ATC's former owners. The Company has accounted for this payment as part of the purchase price.

Accounts receivable from Hector Communications Corporation: The Company provides services for Hector Communications Corporation ("HCC"), a former subsidiary of the Company. Several of the Company's officers and directors work in similar capacities for HCC. Outstanding receivable balances from HCC were $357,000 and $307,000 at December 31, 1997 and 1996, respectively. Accounts with HCC are handled on an open account basis.

Property, plant and equipment: Property, plant and equipment is recorded at cost. Depreciation is computed using principally the straight-line method. Depreciation included in costs and expenses was $2,086,366, $1,927,081, and $1,950,563 for 1997, 1996 and 1995, respectively. Maintenance and repairs are charged to operations and additions or betterments are capitalized. Items of property sold, retired or otherwise disposed of are removed from the asset and accumulated depreciation accounts and any gains or losses on disposal are reflected in operations.

Excess of cost over net assets acquired: The excess of cost over net assets of subsidiaries acquired in purchase transactions is being amortized on the straight-line method over periods of from 10 to 15 years. Amortization included in costs and expenses was $385,144, $376,222 and $44,789 in 1997, 1996 and 1995, respectively.

Line of credit: The Company has a $2,000,000 line of credit from First Bank of Minneapolis. Interest on borrowings on the credit line are at the bank's average CD rate plus 1.5%. The Credit line expires June 30, 1998. There were no outstanding borrowings against the credit line at December 31, 1997 or 1996.

Foreign currency translation: Assets and liabilities denominated in foreign currencies were translated into U.S. dollars at year-end exchange rates. Revenue and expense transactions were translated using average exchange rates. In 1997, the Company recognized a foreign currency translation loss of $73,696 upon liquidation of its Canadian subsidiary. Gains or losses from other currency exchange transactions during the periods were not material.

Net income per share: Effective December 15, 1997, the Company adopted the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share". The Statement requires the Company to present its net income per share in basic and diluted forms and to restate net income per share for prior periods to conform with the new statement. Basic net income per common share is based on the weighted average number of common shares outstanding during each year. Diluted net 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. Adoption of the new standard did not have a material effect on the Company's net income per share.

Changes in accounting principles: The Financial Accounting Standards Board ("FASB") has issued SFAS No. 130, "Reporting Comprehensive Income". This statement establishes standards for reporting and presenting comprehensive income and its components in the financial statements. SFAS No. 130 is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required. Adoption of this standard will have no material effect on the Company's results of operations or financial position.

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Change of presentation: Certain amounts in the 1996 and 1995 financial statements have been reclassified to conform with the 1997 financial statement presentation. These reclassifications had no effect on net income or stockholders' equity as previously reported.

NOTE 2 - DISCONTINUED OPERATIONS

Discontinued operations represent the Company's contract manufacturing operations. Effective November 4, 1996, the Company sold all the assets of these operations, except cash and accounts receivable, to Nortech Systems, Inc. (Nasdaq National Market System: NSYS) for $1,500,000 cash and a note receivable of $4,866,597. The note bears interest at the prime rate established by First Bank of Minneapolis and is secured by the assets sold. The balance outstanding on the note receivable at December 31, 1997 was $4,557,767.

The Company's consolidated financial statements and accompanying notes present separately the net assets and results of operations of the discontinued operations. Operating results of the discontinued contract operations were as follows:

	Ten Months Ended October 31 1996	Year Ended December 31 1995
Sales	$ 13,517,501	$ 19,953,130
Costs and expenses	14,684,080	19,697,551
Interest income, net	35,361	40,749
Income (loss) before income taxes	(1,131,218)	296,328
Income tax expense (benefit)	(412,000)	136,000
Income (loss) from operations	(719,218)	160,328
Loss on disposal of value-added design and electronic assembly operations, net of income tax expense of $77,000	(2,106)	
Net income (loss)	$ (721,324)	$ 160,328

Net assets of discontinued operations at December 31, 1996 consisted of the following :

Working capital	$ 267,679
Deferred taxes	269,000
	$ 536,679

NOTE 3 - INVESTMENT IN DEBT AND EQUITY SECURITIES

Marketable securities consist primarily of equity securities, are classified as trading securities, and are carried at market value. Aggregate cost, based on the weighted average purchase price for each security, and market value was as follows:

	December 31 1997	December 31 1996
Aggregate cost	$ 835,156	$ 963,297
Valuation allowance	(33,111)	(73,515)
Aggregate market value	$ 802,045	$ 889,782

Investment income (loss) includes $40,404, ($9,687) and $90,046 for changes in the unrealized holding gains and losses in 1997, 1996 and 1995, respectively. Investment income also includes gain on sales of marketable securities of $14,926 in 1997 and $99,800 in 1995.

The Company's Puerto Rico subsidiary owns a portfolio of AAA rated mortgage-backed securities it is holding to maturity. At December 31, 1997, the amortized cost basis of the securities was $3,249,000. Market value of the securities was $3,213,000 resulting in a gross unrealized holding loss of $36,000, which is not reflected in the consolidated financial statements.

The same subsidiary has invested in twelve month U.S. Treasury bills which mature in February, 1998. These securities are available-for-sale. Amortized cost of the securities is $5,249,314, which approximates fair value.

The Company has an investment in convertible bonds issued by Hector Communications Corporation (Note 1). The bonds mature in 2002 and the Company considers them available-for-sale. Amortized cost of the bonds was $108,000 which approximates their market value.

NOTE 4 - INVENTORIES

Inventories are carried at the lower of cost (first-in, first out method) or market and consist of :

	December 31	
	1997	1996
Finished goods	$ 5,237,907	$ 3,957,655
Raw and processed materials	13,200,624	9,904,259
	$ 18,438,531	$ 13,861,914

NOTE 5 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment and the estimated useful lives are as follows:
<TABLE>
<CAPTION>

<S>	Estimated useful life	December 31 1997 <C>	1996 <C>
Land		$ 291,989	$ 292,619
Buildings	7-30 years	2,965,102	2,905,108
Machinery and equipment	3-15 years	21,351,745	19,119,653
Furniture and fixtures	5-10 years	2,073,739	1,982,324
		26,682,575	24,299,704
Less accumulated depreciation		17,007,714	15,335,114
		$ 9,674,861	$ 8,964,590

</TABLE>

NOTE 6 - EMPLOYEE BENEFIT PLANS

The Company has an Employee Savings Plan (401(k)) and matches a percentage of employee contributions up to eight percent of compensation. Contributions to the plan in 1997, 1996 and 1995 were $89,000, $73,000, and $77,000 respectively.

The Company does not provide post retirement benefits to its employees.

NOTE 7 - LEASE COMMITMENTS

The Company leases land, buildings and equipment under operating leases with original terms from one to ten years. Certain of these leases contain renewal and purchase options. Rent expense charged to operations was $640,000, $603,000 and $454,000 in 1997, 1996 and 1995 respectively.

At December 31, 1997, the Company was obligated under noncancellable operating leases to make minimum annual future lease payments as follows:

Year Ending December 31:	
1998	$ 287,000
1999	304,000
2000	266,000
2001	266,000
2002	266,000
After 2002	354,000
	$ 1,743,000

NOTE 8 - COMMON STOCK AND STOCK OPTIONS

Common shares are reserved in connection with the Company's 1992 stock plan under which 900,000 shares of common stock may be issued pursuant to stock options, stock appreciation rights, restricted stock or deferred stock granted to officers and key employees. Exercise prices of stock options under the plan cannot be less than fair market value of the stock on the date of grant. Rules and conditions governing awards of stock options, stock appreciation rights and restricted or deferred stock are determined by the Compensation Committee of the Board of Directors, subject to certain limitations incorporated into the plan. At December 31, 1997, 169,483 shares remained available to be issued under the plan. Options granted to key employees in 1995, 1996 and 1997 are subject to vesting. One third of the options issued vest immediately, the remaining two thirds vest equally over the next two years. All employee options expire five years from date of grant.

Common shares are also reserved for issuance in connection with a nonqualified stock option plan under which up to 200,000 shares may be issued to nonemployee directors. The plan provides for the automatic grant of nonqualified options for 2,000 shares of common stock annually to each nonemployee director concurrent with the annual stockholders' meeting. Exercise price will be the fair market value of the stock at the date of grant. Options issued under this plan expire ten years from date of grant. At December 31, 1997, 84,000 shares are available to be issued under the plan.

A summary of changes in outstanding employee and director stock options during the three years ended December 31, 1997 is as follows:

	Number of shares	Weighted average exercise price per share
Outstanding at December 31, 1994	457,700	$ 8.62
Granted	153,700	14.29
Exercised	(173,311)	7.37
Canceled	(2,667)	14.00
Outstanding at December 31, 1995	457,700	11.09
Granted	167,000	14.75
Exercised	(52,381)	8.95
Canceled	(8,352)	13.95
Outstanding at December 31, 1996	541,689	12.38
Granted	197,700	13.82
Exercised	(181,851)	11.30
Canceled	(32,266)	14.04
Outstanding at December 31, 1997	525,272	$ 13.19

At December 31, 1997, 384,039 stock options are currently exercisable. The following table summarizes the status of Communications Systems, Inc. stock options outstanding at December 31, 1997:

Range of Exercise Prices	Shares	Option Life	Weighted Average Remaining Exercise Price
$ 5.31 to $ 9.99	71,100	1.7 years	$ 8.12
$10.00 to $14.99	397,172	3.5 years	13.74
$15.00 to $15.95	57,000	5.3 years	15.70

EMPLOYEE STOCK PURCHASE PLAN

The Company maintains an Employee Stock Purchase Plan for which 200,000 common shares have been reserved. Under the terms of the plan, participating employees may acquire shares of common stock through payroll deductions up to the lower of 10% of compensation or $25,000. The price at which shares can be purchased is 85% of the lower of fair market value for such shares on one of two specified dates in each plan year. A participant is limited in any plan year to acquiring the number of shares which their payroll deductions for the year would purchase based on the market price on the first day of the plan year. Shares issued to employees under the plan were 16,622, 14,346 and 23,567 for the plan years ended August 31, 1997, 1996 and 1995, respectively. At December 31, 1997 employees had subscribed to purchase an additional 14,140 shares in the current plan year ending August 31, 1998.

PRO FORMA FINANCIAL INFORMATION

The Company has adopted the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," but applies APB Opinion No. 25, "Accounting for Stock Issued to Employees" for measurement and recognition of stock-based transactions with its employees. If the Company had elected to recognize compensation cost for its stock based transactions using the method prescribed by SFAS No. 123, pro forma net income and net income per share would have been as follows:

	Year Ended December 31		
	1997	1996	1995
Net Income	$ 10,254,975	$ 7,740,304	$ 8,774,114
Basic Net Income Per Share	$ 1.11	$ .83	$ .96
Diluted Net Income Per Share	$ 1.10	$ .83	$ .95

The fair value of the Company's stock options and Employee Stock Purchase Plan transactions used to compute pro forma net income and net income per share disclosures is the estimated present value at grant date using the Black-Scholes option-pricing model with the following assumptions for 1997: expected volatility of 25%, a risk free interest rate of 6.2%, an expected holding period of four years for key employee options and seven years for director options, and a 2.6% dividend yield. Assumptions used to compute 1996 and 1995 fair values were an expected volatility of 27%, a risk free interest rate of 6.8%, an expected holding period of four years for key employee options and seven years for director options, and a 1.8% dividend yield. Pro forma stock-based compensation cost was $682,000, $492,000 and $310,000 in 1997, 1996 and 1995, respectively. The fair value of all options issued in 1997, 1996 and 1995 was $690,000, $714,000 and $650,000, respectively.

EMPLOYEE STOCK OWNERSHIP PLAN

During 1985, the Board of Directors adopted a leveraged employee stock ownership plan (ESOP) and authorized the Company to advance the ESOP or guarantee debt of up to $2,000,000 to enable the plan to purchase the Company's common stock in the open market. Advances to the plan bear interest at 85% of prime and are repaid through Company contributions to the plan. There were no outstanding advances to the ESOP at December 31, 1997.

At December 31, 1997, the ESOP held 296,162 shares of the Company's common stock, all of which has been allocated to the accounts of eligible employees. Contributions to the plan are determined by the Board of Directors and can be made in cash or shares of the Company's stock. A cash contribution of $72,000 was made for the year ended December 31, 1995. The Company accrued a 1996 ESOP contribution of $300,000, for which the Company issued 20,870 shares of common stock to the ESOP in February, 1997. The Company's 1997 ESOP contribution was $350,000 of cash.

All eligible employees of the Company participate in the ESOP after completing one year of service. Contributions are allocated to each participant based on compensation and vest 30% after three years of service and incrementally thereafter, with full vesting after seven years.

PURCHASES OF COMMUNICATIONS SYSTEMS, INC. COMMON STOCK

In August, 1996, the Company's Board of Directors authorized the purchase and retirement, from time to time, of up to 500,000 shares of the Company's common stock on the open market, or in private transactions consistent with overall market and financial conditions. In 1996, the Company purchased and retired 255,495 common shares under this authorization, at a cost of $3,263,000.

AUSTIN TAYLOR COMMUNICATIONS, LTD.

In connection with refinancing debt associated with the purchase of Austin Taylor Communications, Ltd., the Company issued an option to the Welsh Development Agency (WDA) to purchase 20,142 shares of CSI common stock at $7.35 share. The option was exercised by the WDA in January, 1995. Subsequent to the exercise of the stock option, the Company purchased and retired the stock from the WDA.

Effective February 1, 1992, the Company granted the Managing Director of Austin Taylor an option to acquire up to 5% of Austin Taylor's outstanding common stock at a price of one British pound per share (approximately $1.65 U.S. per share at December 31, 1997). The price per share was management's best estimate of the fair market value of Austin Taylor common stock at the date of grant. If the option is exercised, the shares are transferable only to the Company, and the transfer price is management's best estimate of the fair market value of a publicly traded company in Austin Taylor's industry (eighteen times Austin Taylor's average pretax earnings for the preceding three years.) At December 31, 1997, there were 1,005,030 shares of Austin Taylor common stock issued and outstanding. The average pretax earnings of Austin Taylor over the last three years was $1.19 per share.

NOTE 9 - INCOME TAXES

Income tax expense from continuing operations consists of the following:
<TABLE>
<CAPTION>

	Year Ended December 31		
	1997	1996	1995
Currently payable income taxes:			
<S>	<C>	<C>	<C>
Federal	$ 898,000	$ 1,444,000	$ 966,000
State	168,000	294,000	105,000

Puerto Rico	826,000	646,000	589,000
Canada	40,000	10,000	40,000
United Kingdom	414,000	247,000	450,000
	2,346,000	2,641,000	1,943,000
Tax effect of disqualified employee incentive stock options	151,000	13,000	243,000
Deferred income taxes (benefit)	703,000	(404,000)	(22,000)
-			
	$ 3,200,000	$ 2,250,000	$ 2,164,000

</TABLE>

A subsidiary, Suttle Caribe, Inc., operates in Puerto Rico, and is qualified under Internal Revenue Service Code section 936 for credit against U.S. income taxes. Under provisions of the Omnibus Budget Reconciliation Act of 1993, Congress set limits on the section 936 credit which went into effect for the 1994 tax year. As a result of the tax credit limitation, the Company incurred $791,000, $352,000 and $272,000 of U.S. federal income tax expense on earnings in Puerto Rico for 1997, 1996 and 1995, respectively.

Earnings of Suttle Caribe, Inc. are 90% exempt from Puerto Rico income taxes through 2003, subject to satisfaction of the employment and investment requirements of the tax exemption grant received by the Company. Distributions by Suttle Caribe, Inc. to the parent company are subject to a tollgate tax at rates which, depending on various factors, range from 3.5% to 10%. The Company has provided for and prepaid toll gate taxes at a 1.75% rate on its Puerto Rico earnings for each year since 1993. The Company has recognized tollgate tax expense at the 3.5% rate on earnings from years prior to 1993 only to the extent distributions were received from Suttle Caribe, Inc. The cumulative amount of undistributed prior earnings on which no tollgate tax has been recognized was approximately $8,078,000 at December 31, 1997. In 1997, the Puerto Rico Treasury Department audited the Company's Puerto Rico tax returns for the years 1993, 1994 and 1995. Settlement of issues raised by the audit did not require a material adjustment to the Company's consolidated financial statements.

In 1997, the Company liquidated its Suttle Apparatus Canada, Ltd. subsidiary and repatriated its retained earnings to the U.S. This repatriation dividend was subject to a Canadian withholding tax of $40,000. This subsidiary was subject to Canadian rather than U.S. income taxes. Canadian pretax income was $21,000 and $80,000 for 1996 and 1995, respectively.

Austin Taylor Communications, Ltd. operates in the U.K. and is subject to U.K. rather than U.S. income taxes. U.K. pretax income was $1,343,000, $791,000, and $1,450,000 in 1997, 1996 and 1995, respectively. Suttle Costa Rica, S.A. operates in Costa Rica and is currently exempt from Costa Rica income taxes. It is the Company's intention to reinvest the remaining undistributed earnings of its Puerto Rico, U.K. and Costa Rica subsidiaries to support the continued operation of those subsidiaries.

The provision for income taxes varied from the federal statutory tax rate as follows:
<TABLE>
<CAPTION>

	Year Ended December 31		
	1997	1996	1995
<S>	<C>	<C>	<C>
Tax at U.S. statutory rate	35.0%	35.0%	35.0%
Surtax exemption	(.7)	(1.0)	(1.0)
U.S. taxes not provided on Puerto Rico operations	(14.1)	(17.0)	(18.3)
State income taxes, net of federal benefit	.8	1.7	1.0
Other	1.6	1.4	2.8
Effective tax rate	22.6%	20.1%	19.5%

</TABLE>

Deferred tax assets and liabilities as of December 31 related to the following:
<TABLE>
<CAPTION>

	1997	1996
Current assets:		
<S>	<C>	<C>
Marketable securities	$ 12,000	$ 26,000
Bad debts	240,000	73,000
Inventory	445,000	365,000

Accrued expenses	383,000	328,000
	$ 1,080,000	$ 792,000
Long term assets and (liabilities):		
Depreciation	$ (324,953)	$ (232,953)
Loss reserves on notes receivable	132,000	130,000
Alternative minimum tax credits	307,000	938,000
	$ 114,047	$ 835,047

</TABLE>

NOTE 10 - INFORMATION CONCERNING INDUSTRY SEGMENTS AND MAJOR CUSTOMERS

The Company's continuing operations are in one business segment - manufacture of telephone station apparatus products. The Company operates in the United States, including Puerto Rico (U.S.), United Kingdom (U.K.), and Costa Rica. Information concerning the Company's continuing operations in the various geographic areas is as follows: <TABLE> <CAPTION>

	Telephone Station Apparatus					
	U.S.	U.K.	Other	Corporate	Eliminations	Consolidated
Year Ended December 31, 1997:						
Revenues:						
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Sales to unaffiliated customers	$ 62,415,513	$ 13,316,138				$ 75,731,651
Transfers between geographic areas			$ 1,642,623		$ (1,642,623)	
Total	$ 62,415,513	$ 13,316,138	$ 1,642,623		$ (1,642,623)	$ 75,731,651
Operating Income	$ 12,195,834	$ 1,138,071	$ 155,887	$ (1,006,975)		$ 12,482,817
Identifiable Assets	$ 53,195,928	$ 9,150,276	$ 1,544,909	$ 13,626,815		$ 77,517,928
Depreciation and Amortization	$ 1,487,420	$ 599,982	$ 257,134	$ 126,974		$ 2,471,510
Capital Expenditures	$ 2,028,550	$ 265,340	$ 524,810	$ 59,373		$ 2,878,073
Year Ended December 31, 1996:						
Revenues:						
Sales to unaffiliated customers	$ 56,473,963	$ 11,263,612	$ 967,365			$ 68,704,940
Transfers between geographic areas	719,583		1,357,653		$ (2,077,236)	
Total	$ 57,193,546	$ 11,263,612	$ 2,325,018		$ (2,077,236)	$ 68,704,940
Operating Income	$ 10,841,084	$ 626,721	$ 118,942	$ (1,182,040)		

						$ 10,404,707
Identifiable Assets	$ 41,386,485	$ 8,147,019	$ 2,083,210	$ 15,979,400		$ 67,596,114
Depreciation and Amortization	$ 1,419,544	$ 549,512	$ 186,937	$ 147,310		$ 2,303,303
Capital Expenditures	$ 1,091,214	$ 368,592	$ 485,483	$ 43,764		$ 1,989,053
Year Ended December 31, 1995:						
Revenues:						
Sales to unaffiliated customers	$ 51,313,001	$ 13,753,235	$ 938,080			$ 66,004,316
Transfers between geographic areas	697,155		1,636,312		$ (2,333,467)	
Total	$ 52,010,156	$ 13,753,235	$ 2,574,392		$ (2,333,467)	$ 66,004,316
Operating Income	$ 9,610,251	$ 1,370,675	$ 169,345	$ (961,677)		$ 10,188,594
Identifiable Assets	$ 36,508,774	$ 8,139,074	$ 1,679,581	$ 15,617,179		$ 61,944,608
Depreciation and Amortization	$ 1,132,236	$ 566,814	$ 139,247	$ 157,055		$ 1,995,352
Capital Expenditures	$ 1,205,477	$ 926,905	$ 101,361	$ 262,745		$ 2,496,488

</TABLE>

Export sales were less than 10% of consolidated revenues in each of the last three years. At December 31, 1997, foreign earnings in excess of amounts received in the United States were approximately $5,962,000.

In 1997, sales to two U.S. customers amounted to 17.6% and 10.0% of consolidated revenues, respectively. No customer accounted for more than ten percent of the Company's consolidated revenues in 1996. In 1995, sales to two U.S. customers amounted to 12.1% and 10.7% of consolidated revenues, respectively.

The Company's station apparatus products are manufactured using plastic parts, wire sub-assemblies, fasteners, brackets, electronic circuit boards and other components, most of which are fabricated by the Company. There are multiple sources of supply for the materials and parts required and the Company is not dependent upon any single supplier, except that the Company's corrosion resistant products utilize a moisture-resistant gel-filled fig available only from Raychem Corporation. The unavailability of the gel-filled figs from Raychem Corporation could have a material adverse effect on the Company. The Company has not generally experienced significant problems in obtaining its required supplies, although from time to time spot shortages are experienced.

(b) SUPPLEMENTAL FINANCIAL INFORMATION

<TABLE>
<CAPTION>

Unaudited Quarterly Operating Results
(in thousands except per share amounts)

	Quarter Ended			
	March 31	June 30	Sept 30	Dec 31
1997				
<S>	<C>	<C>	<C>	<C>
Revenues	$ 16,816	$ 20,181	$ 19,790	$ 18,945
Gross Margins	4,991	6,347	6,775	5,317
Operating income	2,368	3,359	4,033	2,723
Net Income	2,169	2,883	3,154	2,731
Basic Net Income per Share	$ .24	$ .31	$ .34	$ .29
Diluted Net Income per Share	$ .24	$ .31	$ .33	$ .29
1996				
Revenues from Continuing Operations	$ 15,794	$ 16,434	$ 18,391	$ 18,086
Gross Margins	4,631	4,621	5,862	5,872
Operating income from Continuing Operations	2,313	1,925	2,992	3,175
Income from Continuing Operations	2,003	1,668	2,433	2,850
Income (Loss) from Discontinued Operations	42	(369)	(421)	27
Net Income	2,045	1,299	2,012	2,877
Basic Net Income (Loss) Per Share:				
Continuing Operations	$ .21	$ .18	$ .27	$ .31
Discontinued Operations	.01	(.04)	(.05)	
Net Income Per Share	$ .22	$ .14	.22	$ .31
Diluted Net Income (Loss) Per Share:				
Continuing Operations	$ .21	$ .18	$ .26	$ .31
Discontinued Operations	.01	(.04)	(.05)	
Net Income Per Share	$ .22	.14	$ .21	$ .31

Net Income Per Share for the periods presented above has been restated in accordance with SFAS No. 128.
</TABLE>

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information called for by paragraphs [a], [c], [d], [e], and [f] of Item 401 under Regulation S-K, to the extent applicable, will be set forth under the caption "Election of Directors" in the Company's definitive proxy material for its May 19, 1998 Annual Meeting of Shareholders to be filed within 120 days from the end of the Registrant's fiscal year, which information is expressly incorporated by reference herein. The information called for by paragraph [b] of Item 401 is set forth under Item 1[c] herein. The information called for by Item 405 under Regulation S-K, to the extent applicable, will be set forth under the caption "Certain Transactions" in the Company's above referenced definitive proxy material.

ITEM 11. EXECUTIVE COMPENSATION

The information called for by Item 402 under Regulation S-K to the extent applicable, will be set forth under the caption "Executive Compensation" in the Company's definitive proxy materials for its May 19, 1998 Annual Meeting to be filed within 120 days from the end of the Registrant's fiscal year, which information is expressly incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information called for by Item 403 under Regulation S-K will be set forth under the captions "Security Ownership of Certain Beneficial Owners and Management" and "Election of Directors" in the Company's definitive proxy materials for its May 19, 1998 Annual Meeting to be filed within 120 days from the end of the Registrant's fiscal year, which information is expressly incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for by Item 404 under Regulation S-K will be set forth under the caption "Certain Transactions" in the Company's definitive proxy materials for its May 19, 1998 Annual Meeting to be filed within 120 days from the end of the Registrant's fiscal year, which information is expressly incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1) Consolidated Financial Statements

The following Consolidated Financial Statements of Communications Systems, Inc. and subsidiaries appear at pages 15 to 29 herein:

Independent Auditors' Report

Consolidated Balance Sheets as of December 31, 1997 and 1996

Consolidated Statements of Income for the years ended December 31, 1997, 1996 and 1995

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 1997, 1996 and 1995

Consolidated Statements of Cash Flows for the years ended December 31, 1997, 1996 and 1995

Notes to Consolidated Financial Statements

(a) (2) Consolidated Financial Statement Schedule	Page Herein

The following financial statement schedule is being filed as part of this Form 10-K Report:

Independent Auditors' Report	15
Schedule II - Valuation and Qualifying Accounts and Reserves	35

All other schedules are omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.

(a) (3) Exhibits

The exhibits which accompany or are incorporated by reference in this report, including all exhibits required to be filed with this report, are described on the Exhibit Index, which begins on page 37 of the sequential numbering system used in this report.

(b) REPORTS ON FORM 8-K FILED DURING THE THREE MONTHS ENDED DECEMBER 31, 1997

Not Applicable.

SIGNATURES

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

COMMUNICATIONS SYSTEMS, INC.

Dated: March 27, 1998

/s/Curtis A. Sampson

Curtis A. Sampson, Chairman of the Board of Directors, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated:

Each person whose signature appears below constitutes and appoints CURTIS A. SAMPSON and PAUL N. HANSON as his true and lawful attorneys-in-fact and agents, each acting alone, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any or all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, each acting alone, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all said attorneys-in-fact and agents, each acting alone, or his substitute or substitutes, may lawfully do or cause to be done by virtue thereof.

Signature	Title	Date
/s/Curtis A. Sampson - ------------------------------ Curtis A. Sampson	Chairman of the Board of Directors, President, and Director (Principal Executive Officer)	March 27, 1998
/s/Paul N. Hanson - ------------------------------ Paul N. Hanson	Vice President, Treasurer and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 27, 1998
/s/Paul J. Anderson - ------------------------------ Paul J. Anderson	Director	March 27, 1998
/s/Edwin C. Freeman - ------------------------------ Edwin C. Freeman	Director	March 27, 1998
- ------------------------------ Luella Gross Goldberg	Director	March 27, 1998
/s/Frederick M. Green - ------------------------------ Frederick M. Green	Director	March 27, 1998
/s/John C. Ortman - ------------------------------ John C. Ortman	Director	March 27, 1998
- ------------------------------ Joseph W, Parris	Director	March 27, 1998
- ------------------------------ Gerald D. Pint	Director	March 27, 1998
/s/Wayne E. Sampson - ------------------------------ Wayne E. Sampson	Director	March 27, 1998
- ----------------------------- Edward E. Strickland	Director	March 27, 1998

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

OF

COMMUNICATIONS SYSTEMS, INC.

FOR

YEAR ENDED DECEMBER 31, 1997

FINANCIAL STATEMENT SCHEDULE

==

<TABLE>
<CAPTION>

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
Schedule II - Valuation and Qualifying Accounts and Reserves

Description	Balance at Beginning of Period	Additions Charged to Cost and Expenses	Additions Charged to Other Accounts	Deductions from Reserves	Balance at End of Period
Allowance for doubtful accounts:					
Year ended:					
<S>	<C>	<C>	<C>	<C>	<C>
December 31, 1997	$ 306,000	$ 50,000	$ 441,000 (A)	$ 1,000 (B)	$ 796,000
December 31, 1996	$ 288,000	$ 91,000	$ -	$ 73,000 (B)	$ 306,000
December 31, 1995	$ 275,000	$ 60,000	$ -	$ 47,000 (B)	$ 288,000
Inventory valuation reserves:					
Year ended:					
December 31, 1997	$ 1,370,000	$ -	$ -	$ 213,000	$ 1,157,000
December 31, 1996	$ 1,262,000	$ 108,000	$ -	$ -	$ 1,370,000
December 31, 1995	$ 1,262,000	$ -	$ -	$ -	$ 1,262,000
Reserve for assets transferred under contractual arrangements and notes receivable:					
Year Ended:					
December 31, 1997	$ 358,000	$ -	$ 13,000 (C)	$ -	$ 371,000
December 31, 1996	$ 335,000	$ -	$ 23,000 (C)	$ -	$ 358,000
December 31, 1995	$ 377,000	$ -	$ 43,000 (C)	$ 85,000	$ 335,000

- --
(A) Reclassification of allowance for doubtful accounts related to net assets of discontinued operations. (B) Accounts determined to be uncollectible and charged off against reserve.
(C) Interest on notes receivable credited to valuation reserve.
</TABLE>

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

OF

COMMUNICATIONS SYSTEMS, INC.

FOR

YEAR ENDED DECEMBER 31, 1997

EXHIBITS

COMMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
Exhibit Index To
Form 10-K for the Year Ended December 31, 1997

Regulation S-K Exhibit Table Reference	Title of Document	Location in Consecutive Numbering System as Filed With the Securities and Exchange Commission
3.1	Articles of Incorporation, as amended	Filed as Exhibit 3.1 to the Form 10-K Report of the Company for its year ended December 31, 1989 (the "1989 Form 10-K") and incorporated herein by reference.
3.2	Bylaws, as amended	Filed as Exhibit 3.2 to the 1989 Form 10-K and incorporated herein by reference.
10.1	1987 Stock Plan	Filed as Exhibit 10.1 to the Form 10-K Report of the Company for its year ended December 31, 1993 (the "1993 Form 10-K") and incorporated herein by reference.
10.2	Employee Savings Plan	Filed as Exhibit 10.2 to the 1993 Form 10-K and incorporated herein by reference.
10.3	Employee Stock Ownership Plan	Filed as Exhibit 10.3 to the 1993 Form 10-K and incorporated herein by reference.
10.4	Employee Stock Purchase Plan	Filed as Exhibit 10.4 to the 1993 Form 10-K and incorporated herein by reference.
10.5	Stock Option Plan for Nonemployee Directors	Filed as Exhibit 10.5 to the 1993 Form 10-K and incorporated herein by reference.
10.6	1992 Stock Plan	Filed as Exhibit 10.6 to the 1993 Form 10-K and incorporated herein by reference.
10.7	Flexible Benefit Plan	Filed as Exhibit 10.7 to the 1993 Form 10-K and incorporated herein by reference.

10.8	Supplemental Executive Retirement Plan	Filed as Exhibit 10.8 to the 1993 Form 10-K and incorporated herein by reference.
11	Calculation of Earnings Per Share	Filed herewith at page 38
21	Subsidiaries of the Registrant	Filed herewith at page 39
23	Independent Auditors' Consent	Filed herewith at page 40.
24	Power of Attorney	Included in signatures at page 33.

The exhibits referred to in this Exhibit Index will be supplied to a shareholder at a charge of $.25 per page upon written request directed to CSI's Assistant Secretary at the executive offices of the Company.

<TABLE>
<CAPTION>

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CALCULATION OF EARNINGS PER SHARE
EXHIBIT 11

	Twelve Months Ended December 31		
Basic:	1997	1996	1995
<S>	<C>	<C>	<C>
Income from Continuing Operations	$ 10,936,873	$ 8,953,855	$ 8,923,825
Income (loss) from Discontinued Operations		(721,324)	160,328
Net Income	$ 10,936,873	$ 8,232,531	$ 9,084,153
Common shares:			
Weighted average number of common shares outstanding	9,231,858	9,272,825	9,097,771
Basic net income per common share:			
Continuing Operations	$ 1.18	$ .97	$ .98
Discontinued Operations		(.08)	.02
	$ 1.18	$ .89	$ 1.00
Diluted:			
Income from Continuing Operations	$ 10,936,873	$ 8,953,855	$ 8,923,825
Income (loss) from Discontinued Operations		(721,324)	160,328
Adjusted net income	$ 10,936,873	$ 8,232,531	$ 9,084,153
Common and potentially dilutive shares:			
Weighted average number of common shares outstanding	9,231,858	9,272,825	9,097,771
Dilutive effect of stock options outstanding after application of treasury stock method	92,853	78,915	119,450
	9,324,711	9,351,740	9,217,221
Diluted net income per common share:			
Continuing Operations	$ 1.17	$ .96	$ .97
Discontinued Operations		(.08)	.02
	$ 1.17	$ .88	$ .99

</TABLE>

SUBSIDIARIES OF COMMUNICATIONS SYSTEMS, INC.

EXHIBIT 21

Subsidiaries	Jurisdiction of Incorporation
Suttle Apparatus Corporation	Illinois
Suttle Costa Rica, S.A.	Costa Rica
Tel Products, Inc.	Minnesota
Suttle Caribe, Inc.	Minnesota
Austin Taylor Communications, Ltd.	United Kingdom
Automatic Tool & Connector Company, Inc.	New Jersey

All such subsidiaries are 100%-owned directly by Communications Systems, Inc. The financial statements of all such subsidiaries are included in the consolidated financial statements of Communications Systems, Inc.

EXHIBIT 23

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement Nos. 33-28486, 33-39862, 33-39864, 33-60930, 33-83662, 33-99564, and 33-99566 of Communications Systems, Inc. of our report dated February 20, 1998 on the consolidated financial statements and schedule of Communications Systems, Inc. appearing in this Annual Report on Form 10-K of Communications Systems, Inc. for the year ended December 31, 1997.

/s/ Deloitte & Touche LLP
- ------------------------
Deloitte & Touche LLP
March 26, 1998
Minneapolis, Minnesota

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<MULTIPLIER>	1				
<CURRENCY>	U.S. DOLLARS				
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<PERIOD-TYPE>	12-MOS	12-MOS	9-MOS	6-MOS	3-MOS
<FISCAL-YEAR-END>	DEC-31-1995	DEC-31-1996	DEC-31-1996	DEC-31-1996	DEC-31-199 6
<PERIOD-START>	JAN-01-1995	JAN-01-1996	JAN-01-1996	JAN-01-1996	JAN-01-1996
<PERIOD-END>	DEC-31-1995	DEC-31-1996	SEP-30-1996	JUN-30-1996	MAR-31-1996
<EXCHANGE-RATE>	1	1	1	1	1
<CASH>	11,703,536	17,799,398	14,892,182	11,787,963	10,125,255
<SECURITIES>	899,469	889,782	859,890	868,335	864,966
<RECEIVABLES>	8,789,117	10,682,546	11,408,364	9,972,946	9,446,666
<ALLOWANCES>	288,000	306,000	287,000	288,000	288,000
<INVENTORY>	14,828,534	13,861,914	13,211,397	14,701,094	16,027,425
<CURRENT-ASSETS>	36,907,660	44,486,332	41,571,996	38,862,313	37,769,322
<PP&E>	22,295,204	24,299,704	23,744,102	23,547,888	23,004,724
<DEPRECIATION>	13,637,184	15,335,114	15,044,851	14,599,381	14,058,353
<TOTAL-ASSETS>	61,944,608	67,596,114	67,100,204	65,980,912	65,158,501
<CURRENT-LIABILITIES>	7,869,032	8,580,636	8,774,278	7,796,813	8,180,153
<BONDS>	0	0	0	0	0
<PREFERRED-MANDATORY>	0	0	0	0	0
<PREFERRED>	0	0	0	0	0
<COMMON>	459,170	455,365	462,674	467,323	465,561
<OTHER-SE>	53,616,406	58,560,113	57,863,252	57,716,776	56,512,787
<TOTAL-LIABILITY-AND-EQUITY>	61,944,608	67,596,114	67,100,204	65,980,912	65,158,501
<SALES>	66,004,316	68,704,940	50,618,464	32,227,685	15,793,821
<TOTAL-REVENUES>	66,004,316	68,704,940	50,618,464	32,227,685	15,793,821
<CGS>	47,297,078	47,718,676	35,504,434	22,975,386	11,162,664
<TOTAL-COSTS>	47,297,078	47,718,676	35,504,434	22,975,386	11,162,664
<OTHER-EXPENSES>	8,518,644	10,581,557	7,884,875	5,014,938	2,318,496
<LOSS-PROVISION>	0	0	0	0	0
<INTEREST-EXPENSE>	17,806	9,139	16,499	12,007	6,398
<INCOME-PRETAX>	11,087,825	11,203,855	7,703,375	4,540,567	2,448,317
<INCOME-TAX>	2,164,000	2,250,000	1,600,000	870,000	445,000
<INCOME-CONTINUING>	8,923,825	8,953,855	6,103,375	3,670,567	2,003,317
<DISCONTINUED>	160,328	(721,324)	(748,124)	(327,278)	41,358
<EXTRAORDINARY>	0	0	0	0	0
<CHANGES>	0	0	0	0	0
<NET-INCOME>	9,084,153	8,232,531	5,355,251	3,343,289	2,044,675
<EPS-PRIMARY>	1.00	0.89	0.58	0.36	0.22

<EPS-DILUTED>	0.99	0.88	0.57	0.36	0.22

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<NAME>	COMMUNICATIONS SYSTEMS, INC.
<MULTIPLIER>	1
<CURRENCY>	U.S. DOLLARS

<S>	<C>	<C>	<C>	<C>	<C>
<PERIOD-TYPE>	12-MOS	12-MOS	9-MOS	6-MOS	3-MOS
<FISCAL-YEAR-END>	DEC-31-1995	DEC-31-1996	DEC-31-1996	DEC-31-1996	DEC-31-1996
<PERIOD-START>	JAN-01-1995	JAN-01-1996	JAN-01-1996	JAN-01-1996	JAN-01-1996
<PERIOD-END>	DEC-31-1995	DEC-31-1996	SEP-30-1996	JUN-30-1996	MAR-31-1996
<EXCHANGE-RATE>	1	1	1	1	1
<CASH>	11,703,536	17,799,398	14,892,182	11,787,963	10,125,255
<SECURITIES>	899,469	889,782	859,890	868,335	864,966
<RECEIVABLES>	8,789,117	10,682,546	11,408,364	9,972,946	9,446,666
<ALLOWANCES>	288,000	306,000	287,000	288,000	288,000
<INVENTORY>	14,828,534	13,861,914	13,211,397	14,701,094	16,027,425
<CURRENT-ASSETS>	36,907,660	44,486,332	41,571,996	38,862,313	37,769,322
<PP&E>	22,295,204	24,299,704	23,744,102	23,547,888	23,004,724
<DEPRECIATION>	13,637,184	15,335,114	15,044,851	14,599,381	14,058,353
<TOTAL-ASSETS>	61,944,608	67,596,114	67,100,204	65,980,912	65,158,501
<CURRENT-LIABILITIES>	7,869,032	8,580,636	8,774,278	7,796,813	8,180,153
<BONDS>	0	0	0	0	0
<PREFERRED-MANDATORY>	0	0	0	0	0
<PREFERRED>	0	0	0	0	0
<COMMON>	459,170	455,365	462,674	467,323	465,561
<OTHER-SE>	53,616,406	58,560,113	57,863,252	57,716,776	56,512,787
<TOTAL-LIABILITY-AND-EQUITY>	61,944,608	67,596,114	67,100,204	65,980,912	65,158,501
<SALES>	66,004,316	68,704,940	50,618,464	32,227,685	15,793,821
<TOTAL-REVENUES>	66,004,316	68,704,940	50,618,464	32,227,685	15,793,821
<CGS>	47,297,078	47,718,676	35,504,434	22,975,386	11,162,664
<TOTAL-COSTS>	47,297,078	47,718,676	35,504,434	22,975,386	11,162,664
<OTHER-EXPENSES>	8,518,644	10,581,557	7,884,875	5,014,938	2,318,496
<LOSS-PROVISION>	0	0	0	0	0
<INTEREST-EXPENSE>	17,806	9,139	16,499	12,007	6,398
<INCOME-PRETAX>	11,087,825	11,203,855	7,703,375	4,540,567	2,448,317
<INCOME-TAX>	2,164,000	2,250,000	1,600,000	870,000	445,000
<INCOME-CONTINUING>	8,923,825	8,953,855	6,103,375	3,670,567	2,003,317
<DISCONTINUED>	160,328	(721,324)	(748,124)	(327,278)	41,358
<EXTRAORDINARY>	0	0	0	0	0
<CHANGES>	0	0	0	0	0
<NET-INCOME>	9,084,153	8,232,531	5,355,251	3,343,289	2,044,675
<EPS-PRIMARY>	1.00	0.89	0.58	0.36	0.22

<EPS-DILUTED>	0.99	0.88	0.57	0.36	0.22

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<MULTIPLIER>	1
<CURRENCY>	U.S. DOLLARS

<S>	<C>	<C>	<C>
<PERIOD-TYPE>	9-MOS	6-MOS	3-MOS
<FISCAL-YEAR-END>	DEC-31-1997	DEC-31-1997	DEC-31-1997
<PERIOD-START>	JAN-01-1997	JAN-01-1997	JAN-01-1997
<PERIOD-END>	SEP-30-1997	JUN-30-1997	MAR-31-1997
<EXCHANGE-RATE>	1	1	1
<CASH>	23,644,909	20,715,678	18,016,563
<SECURITIES>	796,100	786,325	909,873
<RECEIVABLES>	13,009,181	12,453,420	11,872,707
<ALLOWANCES>	796,000	788,000	306,000
<INVENTORY>	18,105,242	16,055,091	15,260,324
<CURRENT-ASSETS>	56,246,620	50,559,553	47,419,724
<PP&E>	26,072,307	25,793,418	24,776,642
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<PREFERRED>	0	0	0
<COMMON>	465,357	460,061	459,561
<OTHER-SE>	66,427,714	62,853,365	60,590,241
<TOTAL-LIABILITY-AND-EQUITY>	78,675,835	73,386,000	70,352,179
<SALES>	56,787,475	36,997,263	16,816,019
<TOTAL-REVENUES>	56,787,475	36,997,263	16,816,019
<CGS>	38,674,614	25,659,409	11,825,031
<TOTAL-COSTS>	38,674,614	25,659,409	11,825,031
<OTHER-EXPENSES>	8,353,346	5,611,137	2,623,506
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<EXTRAORDINARY>	0	0	0
<CHANGES>	0	0	0
<NET-INCOME>	8,206,328	5,051,963	2,168,539
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