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

FORM 10-Q

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

For the quarterly period ended SEPTEMBER 30, 1998

OR

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

For the transition period from to

Commission File Number: 0-10355

COMMUNICATIONS SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

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

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

(Former name, address, and fiscal year, if changed since last report)

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. YES ___ NO ___

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

CLASS	Outstanding at October 31, 1998
Common Stock, par value $.05 per share	8,793,301

Total Pages (12) Exhibit Index at (NO EXHIBITS)

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS
(unaudited)

<TABLE>
<CAPTION>

Assets:	September 30 1998	December 31 1997
Current assets:		
<S>	<C>	<C>
Cash	$ 16,592,858	$ 17,942,315
Investments in U.S. Treasury securities		5,249,314
Marketable securities	21,150	802,045
Receivables, net	13,252,145	12,571,511
Inventories - Note 2	19,923,846	18,438,531
Prepaid expenses	410,046	684,221
Deferred income taxes	1,080,000	1,080,000
Total current assets	51,280,045	56,767,937
Property, plant and equipment	29,360,359	26,682,575
less accumulated depreciation	(18,695,423)	(17,007,714)
Net property, plant and equipment	10,664,936	9,674,861
Other assets:		
Excess of cost over net assets acquired	4,756,539	2,881,544
Investments in mortgage backed and other securities	2,312,355	3,356,568
Deferred income taxes	112,005	114,047
Notes receivable from sale of assets of discontinued operations	4,357,767	4,557,767
Other assets	703,622	165,204
Total other assets	12,242,288	11,075,130
Total Assets	$ 74,187,269	$ 77,517,928
Liabilities and Stockholders' Equity:		
Current liabilities:		
Accounts payable	$ 2,992,732	$ 2,770,628
Accrued expenses	4,003,182	3,030,736
Dividends payable	890,260	839,399
Income taxes payable	2,103,339	1,613,469
Total current liabilities	9,989,513	8,254,232
Stockholders' Equity	64,197,756	69,263,696
Total Liabilities and Stockholders' Equity	$ 74,187,269	$ 77,517,928

See notes to consolidated financial statements.
</TABLE>

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	1998	1997	1998	1997
<S>	<C>	<C>	<C>	<C>
Sales	$ 18,029,530	$ 19,790,212	$ 52,485,367	$ 56,787,475
Costs and expenses:				
Cost of sales	12,826,725	13,015,205	36,688,322	38,674,614
Selling, general and administrative expenses	2,840,180	2,742,209	8,433,891	8,353,346
Total costs and expenses	15,666,905	15,757,414	45,122,213	47,027,960
Operating income	2,362,625	4,032,798	7,363,154	9,759,515
Other income and (expenses):				
Investment income	330,402	456,567	1,118,636	1,231,813
Interest expense	(1,278)		(3,803)	
Other income, net	329,124	456,567	1,114,833	1,231,813
Income before income taxes	2,691,749	4,489,365	8,477,987	10,991,328
Income taxes (Note 3)	740,000	1,335,000	1,890,000	2,785,000
Net income	$ 1,951,749	$ 3,154,365	$ 6,587,987	$ 8,206,328
Basic net income per share	$ .22	$ .34	$ .72	$ .89
Diluted net income per share	$ .22	$ .33	$ .72	$ .88
Average shares outstanding:				
Weighted average number of common shares outstanding	8,942,618	9,200,989	9,123,609	9,200,989
Dilutive effect of stock options outstanding after application of treasury stock method	18,375	97,796	67,537	97,796
	8,960,993	9,298,785	9,191,146	9,298,785

See notes to consolidated financial statements.

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(unaudited)

	Common Stock		Additional		Cumulative	Stock Option	
	Shares	Amount	Paid in Capital	Retained Earnings	Translation Adjustment	Notes Receivable	Total
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
BALANCE at December 31, 1996	9,107,309	$ 455,365	$ 21,454,353	$ 36,856,285	$ 249,475	$ -	$ 59,015,478
Net income				10,936,873			10,936,873
Shareholder dividends				(3,240,303)			(3,240,303)
Issuance of common stock under Employee Stock Purchase Plan	16,622	831	182,843				183,674
Issuance of common stock to Employee Stock Ownership Plan	20,870	1,044	298,956				300,000
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
Cumulative 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
Net income				6,587,987			6,587,987
Shareholder dividends				(2,627,113)			(2,627,113)
Issuance of common stock to acquire JDL Technologies, Inc.	158,005	7,900	2,204,170				2,212,070
Issuance of common stock under Employee Stock Purchase Plan	12,210	610	112,259				112,869
Issuance of common stock under Employee Stock Option Plan	84,834	4,242	938,102				942,344
Issuance of notes receivable for stock options						(288,225)	(288,225)
Purchase of Communications Systems, Inc. common stock	(788,400)	(39,420)	(2,167,669)	(9,992,581)			(12,199,670)
Cumulative translation adjustment					193,798		193,798
BALANCE at September 30, 1998	8,793,301	$ 439,665	$ 25,219,633	$ 38,521,148	$ 305,535	$ (288,225)	$ 64,197,756

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See notes to consolidated financial statements.

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

	Nine Months Ended September 30	
	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES:		
<S>	<C>	<C>
Net income	$ 6,587,987	$ 8,206,328
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,113,980	1,872,513
Adjustment to marketable securities reserve	(39,171)	(34,459)
Loss on liquidation of foreign subsidiary		73,696
Changes in assets and liabilities:		
Decrease in marketable securities	820,066	128,141
Decrease (increase) in accounts receivable	803,466	(1,859,360)
Increase in inventory	(1,159,803)	(4,337,843)
Decrease in prepaid expenses	275,948	32,717
Increase in deferred income taxes		(269,310)
Increase (decrease) in accounts payable	(769,412)	1,364,665
Increase in accrued expenses	143,855	1,177,422
Increase in income taxes payable	480,000	992,716
Net cash provided by operating activities	9,256,916	7,347,226
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(2,619,135)	(1,981,448)
Decrease in mortgage backed and other investment securities	1,044,213	818,551
Increase in other assets	(536,913)	(600,910)
Changes in assets and liabilities of discontinued operations		536,679
Collection of notes receivable	200,000	201,207
Proceeds from maturities of U.S. Treasury securities	5,249,314	
Payment for purchase of Austin Taylor Communications, Ltd.		(79,947)
Payment for purchase of JDL Technologies, Inc.	(32,260)	
Net cash provided by (used in) investing activities	3,305,219	(1,105,868)

CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends paid	(2,576,252)	(2,291,991)
Proceeds from issuance of common stock	766,988	2,009,682
Purchases of Communications Systems, Inc. common stock	(12,199,670)	
Net cash used in financing activities	(14,008,934)	(282,309)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	97,342	(113,538)
NET INCREASE IN CASH AND CASH EQUIVALENTS	(1,349,457)	5,845,511
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	17,942,315	17,799,398
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 16,592,858	$ 23,644,909
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Income taxes paid	$ 1,400,130	$ 1,786,294
Interest paid	3,803	-

See notes to consolidated financial statements.

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS

The balance sheet and statement of stockholders' equity as of September 30, 1998, the statements of income for the three and nine month periods ended September 30, 1998 and 1997, and the statements of cash flows for the nine month periods ended September 30, 1998 and 1997, have been prepared by the Company without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows at September 30, 1998 and 1997 have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested these condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's December 31, 1997 Annual Report to Shareholders. The results of operations for the periods ended September 30 are not necessarily indicative of the operating results for the entire year.

Effective January 1, 1998, the Company has adopted the provisions of Financial Accounting Standards Board Statement No. 130, "Reporting Comprehensive Income" (SFAS No. 130). This statement establishes standards for reporting and presenting comprehensive income and its components in the financial statements. The Company's total comprehensive income for the three-month periods ended September 30, 1998 and 1997 was $2,074,472 and $3,076,770, respectively. The Company's total comprehensive income for the nine-month periods ended September 30, 1998 and 1997 was $6,781,785 and $7,968,815, respectively.

Effective August 7, 1998, in a noncash transaction, the Company acquired JDL Technologies, Inc. in exchange for 158,005 shares of its common stock. The acquisition was accounted for as a purchase. The excess of cost over net assets acquired in the transaction was $2,396,000 which is being amortized on a straight-line basis over 5 years. The results of operations of JDL Technologies, Inc., which are not material to the Company's financial statements, have been included in the Company's operations effective August 7, 1998.

In February, 1997 the Company issued 20,870 shares of the Company's common stock to the Employee Stock Ownership Plan in payment of its 1996 obligation. In a noncash transaction, the Company recorded additional stockholders' equity of $300,000 (reflecting the market value of the stock at the time of the contribution) and reduced accrued expenses by the same amount.

NOTE 2 - INVENTORIES

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

	September 30 1998	December 31 1997

Finished Goods	$ 7,394,632	$ 5,237,907
Raw Materials	12,574,214	13,200,624
Total	$ 19,923,846	$ 18,438,531

NOTE 3 - INCOME TAXES

Income taxes are computed based upon the estimated effective rate applicable to operating results for the full fiscal year. For the periods ended September 30, 1998 and 1997 income taxes do not bear a normal relationship to income before income taxes, primarily because income from Puerto Rico operations are taxed at rates lower than the U.S. rate.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Nine Months Ended September 30, 1998 Compared to Nine Months Ended September 30, 1997

Sales totaled $52,485,000, a decrease of $4,302,000 or 8% from the 1997 period. Operating income was $7,363,000, a decrease of $2,396,000 or 25% from 1997. Sales to domestic (U.S. and Puerto Rico) customers decreased $2,855,000 or 6%. Sales to the Big 6 telephone companies (the five Regional Bell Operating Companies [RBOCs] and GTE) decreased $3,467,000 or 12%. The decline in sales to this market was due to purchase pattern adjustments caused by the merger of two RBOCs and inventory overstocks at a third RBOC. Sales to this market accounted for 57% of domestic sales in the 1998 period. Sales to electrical distributors and original equipment manufacturers increased $332,000 or 3%. Sales in Puerto Rico increased $325,000 or 24%. The acquisition of JDL Technologies added $1,347,000 to sales for the 1998 period. Sales to retailers decreased $1,389,000 or 31%.

The sales decreases were spread over all of the Company's product groups. Sales of the Company's CorroShield line of corrosion resistant connectors, which has lead the Company's sales growth, were 5% lower for 1998 than in the 1997 period. CorroShield product sales totaled $16,488,000 in the 1998 period compared to $17,348,000 in 1997. Sales of conventional voice products declined $2,226,000 or 11%. The Company believes most of the sales decline of these products is due to customers converting to the CorroShield product. Sales of data products decreased $949,000 or 18%. Sales of fiber optic connector products decreased $627,000 or 19%.

Sales to international customers decreased $1,447,000 or 12%. Sales by Austin Taylor, the Company's United Kingdom based subsidiary, decreased $988,000 or 10% due to lower sales of metal street cabinets and cable television ("CATV") customer premise equipment to U.K. based customers. U.S. export sales, including sales to Canada, decreased $459,000 or 20% due to lower sales of fiber products.

Consolidated gross margin as a percentage of sales was 30%, compared to 32% in the 1997 period. Margin percentages earned in U.S. plants were 33% compared to 35% in 1997. Margins earned on Austin Taylor products declined to 18% from 19% in the 1997 period. The decline in gross margin percentages was principally due to overhead inefficiencies resulting from lower than anticipated sales volume.

Selling, general and administrative expenses increased $80,000 or 1% from the 1997 period. The increase was due to the addition of JDL Technologies operations which offset lower sales and delivery expenses in the Company's telephone station apparatus operations.

Investment income, net of interest expense, decreased $117,000 from the 1997 period due to reduced cash balances available for investment. The Company's effective income tax rate was 22% compared to 25% in the 1997 period. The Company's tax rate is lower than the full U.S. rate due to tax exemptions and benefits received by the Company's Puerto Rico operations. The Company's 1998 tax rate is lower than the 1997 tax rate due to lower profits in Puerto Rico, which reduced the percentage of the Company's income subject to the full U.S. tax rate. Net income decreased $1,618,000, or 20%.

Three Months Ended September 30, 1998 Compared to Three Months Ended September 30, 1997

Sales totaled $18,030,000, a decrease of $1,761,000 or 9% from the 1997 period. Operating income was $2,363,000, a decrease of $1,670,000 or 41% from 1997. Sales to domestic (U.S. and Puerto Rico) customers decreased $980,000 or 6%.

Sales to the Big 6 telephone companies decreased $745,000 or 8%. The decline in sales to this market was due to purchase pattern adjustments caused by the merger of two RBOCs and inventory overstocks at a third RBOC. Sales to this market accounted for 57% of domestic sales in the 1998 period. Sales to retailers decreased $1,040,000 or 56% due to lower sales to Tandy Corporation. Sales to electrical distributors and original equipment manufacturers decreased $445,000 or 11%. Sales in Puerto Rico increased $16,000 or 3%. The acquisition of JDL Technologies added $1,347,000 to sales for the 1998 period.

The sales decreases were spread over all of the Company's product groups. Sales of the Company's CorroShield line of corrosion resistant connectors, which has lead the Company's sales growth, were 5% lower for 1998 than in the 1997 period. The Big 6 telephone companies have been the Company's principal markets for CorroShield products. Sales of conventional voice products decreased $2,018,000 or 27%. Sales of fiber optic connector products decreased $241,000 or 21%.

Sales to international customers decreased $781,000 or 20%. Sales by Austin Taylor, the Company's United Kingdom based subsidiary, decreased $608,000 or 19% due to lower sales of metal street cabinets and cable television ("CATV") customer premise equipment to U.K. based customers. U.S. export sales, including sales to Canada, decreased $173,000 or 26% due to lower sales of fiber products and lower sales to Far East customers. The Company believes its sales in this region are being hurt by the currency devaluations that have followed the economic crisis in this area.

Gross margin as a percentage of sales was 29% compared to 34% in the 1997 period. Gross margin percentage in U.S. plants declined to 32% from 37% in 1997. Margins earned on Austin Taylor products were 13% compared to 19% in the 1997 period. The decline in gross margin percentages was principally due to overhead inefficiencies resulting from lower than anticipated sales volume.

Selling, general and administrative expenses increased $397,000, or 14%, from the 1997 period. The increase was due to the addition of JDL Technologies operations which offset lower sales and delivery expenses in the Company's telephone station apparatus operations.

Investment income, net of interest expense, decreased $127,000 from the 1997 period due to reduced cash balances available for investment. The Company's effective income tax rate was 27% compared to 30% in the 1997 period. The Company's tax rate is lower than the full U.S. rate due to tax exemptions and benefits received by the Company's Puerto Rico operations. . The Company's 1998 tax rate is lower than the 1997 tax rate due to lower profits in Puerto Rico, which reduced the percentage of the Company's income subject to the full U.S. tax rate. The Company's tax rate was higher in this 1998 quarterly period than in earlier quarters during the year due to higher than anticipated toll gate tax expenses on dividends from the Company's Puerto Rico subsidiary. Net income decreased $1,203,000, or 38%.

Liquidity and Capital Commitments

At September 30, 1998, the Company held approximately $16,593,000 of cash compared to $17,942,000 at December 31, 1997. Working capital was $41,291,000 compared to $48,514,000 at December 31, 1997. The Company's current ratio was 5.1 to 1 compared to 6.9 to 1 at December 31, 1997. In addition to its cash and working capital balances, the Company also holds investments in long-term securities and notes receivable totaling $6,670,000.

Net cash provided by operating activities was $9,257,000 compared to $7,347,000 in the first nine months of 1997. Cash was utilized during the period to finance increased inventory levels, purchase new plant and equipment, pay dividends and repurchase the Company's common stock.

The Company's Board of Directors has issued authorizations to purchase and retire up to 1,000,000 shares of the Company's common stock on the open market or in privately negotiated transactions consistent with overall market and financial conditions. At September 30, 1998, the Company had purchased and retired 788,400 shares of stock at a cost of $12,200,000. The Company received $767,000 and $2,010,000 from stock issuances due to exercise of employee stock options in 1998 and 1997, respectively.

Under provisions of the Small Business Job Protection Act of 1996, the possessions tax credit, which shelters the Company's Puerto Rico income from U.S. income tax, 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 applied 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 1998 at the full U.S. rate, income tax expense would have increased by approximately $1,800,000.

The Company's balance sheet remains strong, with stockholders' equity of $64,198,000 and no long-term debt. The Company has available a $2,000,000 bank line of credit. Management believes, based on the Company's current financial position and projected future expenditures, that sufficient funds are available to meet the Company's anticipated needs.

Year 2000 Issues

The software used by the Company's data processing and management control systems was originally designed to use references to calendar dates on an abbreviated basis. Under this system, references to the calendar year are abbreviated to the last two digits of the year, i.e. 1998 is abbreviated as "98". Most software using this system does not recognize that the year 2000, abbreviated as "00", follows 1999. This causes computing errors in date sensitive processes. The Company has surveyed its operations to locate computer systems which may be subject to this error.

The Company's accounting and management control systems for its plants in the U.S., Puerto Rico and Costa Rica utilize a company-wide computer network centered in the Company's Hector, MN corporate office. The hardware and software used in operating the network are all purchased from third party suppliers. The Company has contracted with these suppliers to obtain the necessary hardware and software to bring its central computer system into Year 2000 compliance on a current basis. However, certain elements of the data network itself are not compliant and will be upgraded on an as needed basis in 1999 and 2000.

The Company's U.K. facilities are not currently Year 2000 compliant. The Company has decided to bring this facility up to compliance by integrating it into the existing U.S. network. The Company is currently installing and testing this network expansion as well as training U.K. employees in use of this system. The Company expects the system to be operational in the U.K. by December 31, 1998. Total cost to upgrade to Year 2000 compliance companywide is estimated at $150,000.

At the current time, none of the Company's products contain embedded controllers or microprocessors. None of the products are date sensitive or subject to the Year 2000 problem.

The Company has also been in contact with its major customers and suppliers to estimate the extent to which it may be vulnerable to their respective year 2000 problems. The Company is reliant on third parties for many critical functions, including transportation, supplies, utilities and communications services. It cannot quantify the effect Year 2000 problems might have on these customers and suppliers. As a result, although the Company does not believe Year 2000 problems will cause a material disruption of its operations, it will continue to monitor the issue and modify its business plans and procedures as the situation warrants.

- --
Statements regarding the Company's anticipated performance in future periods are forward looking and involve risks and uncertainties, including but not limited to: buying patterns of the Regional Bell Operating Companies and other customers, competitive products, and other factors.
- --

PART II. OTHER INFORMATION

Items 1 - 6. Not Applicable

Signatures

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

Communications Systems, Inc.

By /s/ Paul N. Hanson
Paul N. Hanson
Vice President and
Chief Financial Officer

Date: November 13, 1998

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