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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, 1996

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
(State or other jurisdiction
of incorporation or organization)

41-0957999
(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

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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. ()

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$93,673,000 based upon the closing sale price of the Company's common stock on the NASDAQ National Market System on March 21, 1997.

As of March 21, 1997 there were outstanding 9,191,213 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 22, 1997 is incorporated by reference into Part III of this Form 10-K.

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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. Further information regarding the acquisition is also contained in the Company's Form 8-K Report filed January 6, 1996, which is incorporated herein by reference.

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. Further information regarding the divestiture is also contained in the Company's Form 8-K Report filed November 18, 1996, which, as amended by a Form 8 amendment filed November 19, 1996, is incorporated herein by reference.

(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 \$52,652,000 in 1996, or 77% of revenues from continuing operations. Sales by Austin Taylor Communications accounted for \$11,264,000 or 16% of revenues from continuing operations. Sales by Automatic Tool and Connector Co. were \$4,789,000 or 7% of revenues from continuing operations.

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(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 8" telephone companies (the seven 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 8 telephone companies, both directly and through distribution, were approximately \$34,271,000 in 1996 and \$31,577,000 in 1995, which represented about 65% and 62% of Suttle Apparatus' sales in 1996 and 1995, respectively. Sales to Sprint North Supply, a principal distributor serving this market were approximately 10% and 15% of Suttle Apparatus' sales in 1996 and 1995, respectively.

Approximately 10% of Suttle Apparatus' 1996 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' 1996 revenues.

The balance of Suttle Apparatus' sales in 1996 and 1995 were to original equipment manufacturers and non-Big 8 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.

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(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, 1997 were approximately \$4,600,000 compared to approximately \$4,300,000 at March 1, 1996. 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.

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, as well as its registered trademark "Tel" are important to its business. The Company regularly supports these names by trade advertising and believes they are well known in the marketplace.

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(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 Northern Telecom Europe, AT&T Europe and NYNEX. Austin Taylor has been a primary source of supply for some products to British Telecom ("BT"), the United Kingdom's principal telephone company. However, in the past two years sales contracts with BT for line jacks and modular boxes have been lost to competitors. Sales to British Telecom accounted for 8% and 16% of Austin Taylor sales in 1996 and 1995, respectively. 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 76% and 79% of Austin Taylor sales were to United Kingdom customers in 1996 and 1995, 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 \$1,531,000 at March 1, 1997 compared to \$1,660,000 at March 1, 1996. 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 Union, New Jersey, ATC manufactures a line of high performance fiber optic connectors, interconnect devices and coaxial 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 both 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. Major customers include original equipment manufacturers, including Hubbell and Panduit. Export sales of ATC products were \$528,000 in 1996, accounting for 11% of ATC's sales.

Outstanding customer orders for ATC's products were approximately \$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. Sales by Zercom Corporation accounted for 23% of

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, 1997 the Company employed 909 people. Of this number, 896 were engaged in telephone equipment manufacturing operations (including 246 in Puerto Rico, 178 in Hector, Minnesota, 49 in Union, New Jersey, 256 in Costa Rica and 167 in Wales) and 13 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, 1997 were as follows:

Name	Age	Position (1)
Curtis A. Sampson	63	Chairman of the Board, President and Chief Executive Officer [1970]
Jeffrey K. Berg	54	President and General Manager Suttle Apparatus Corporation [1990]
Paul N. Hanson	50	Vice President - Finance, Treasurer and Chief Financial Officer [1982]
John C. Hudson	52	Managing Director, Austin Taylor Communications, Ltd. [1992]

(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 20,000 square foot facility in Union, 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:

<TABLE>
<CAPTION>

	1996		1995	
	High	Low	High	Low
<S>	<C>	<C>	<C>	<C>
First	\$16.25	\$13.25	\$15.00	\$12.00
Second	16.50	12.75	18.75	13.50
Third	15.88	11.25	20.00	13.75
Fourth	16.00	12.50	16.75	12.75

(b) HOLDERS

At March 1, 1997 there were approximately 830 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 1995 and 1996 were as follows:

January 1, 1995 - April, 1995	\$.06
July 1, 1995 - April, 1996	.07
July 1, 1996 - Present	.08

ITEM 6. SELECTED FINANCIAL DATA

<TABLE>
<CAPTION>

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

	Year Ended December 31			
	1996	1995	1994	1993
----- 1992				

<u><S></u>	<u><C></u>	<u><C></u>	<u><C></u>	<u><C></u>	<u><C></u>
Revenues From Continuing Operations 43,291	\$ 68,705	\$ 66,004	\$ 57,077	\$ 47,896	\$
Costs and Expenses:					
Cost of Sales 30,206	47,719	47,297	40,812	33,348	
Selling, General and Administrative Expenses 6,733	10,581	8,519	8,180	7,126	
<hr/> Total Costs and Expenses 36,940	<hr/> 58,300	<hr/> 55,816	<hr/> 48,992	<hr/> 40,474	
Operating Income From Continuing Operations 6,351	10,405	10,189	8,086	7,422	
Other Income, Net 228	799	899	341	567	
Income From Continuing Operations Before Income Taxes 6,579	11,204	11,088	8,427	7,988	
Income Tax Expense 1,261	2,250	2,164	1,616	1,308	
<hr/> Income From Continuing Operations 5,318	<hr/> 8,954	<hr/> 8,924	<hr/> 6,811	<hr/> 6,680	
Income (Loss) From Discontinued Operations, Net of Taxes 161	(721)	160	(7)	55	
<hr/> Income Before Cumulative Effect of Change in Accounting Principle 5,479	<hr/> 8,233	<hr/> 9,084	<hr/> 6,804	<hr/> 6,735	
Cumulative Effect of Change in Accounting Principle 481					
<hr/> Net Income 5,960	<hr/> \$ 8,233	<hr/> \$ 9,084	<hr/> \$ 6,804	<hr/> \$ 6,735	<hr/> \$
<hr/> <hr/>					
Net Income (Loss) Per Common and Common Equivalent Share:					
Continuing Operations .60	\$.96	\$.97	\$.75	\$.74	\$
Discontinued Operations .02	(.08)	.02	-	.01	
Cumulative Effect of Change in Accounting Principle .05					
<hr/> Net Income Per Share .67	<hr/> \$.88	<hr/> \$.99	<hr/> \$.75	<hr/> \$.75	<hr/> \$
<hr/> <hr/>					
Cash Dividends Per Share .17	\$.30	\$.26	\$.22	\$.19	\$
<hr/> <hr/>					
Average Common and Common Equivalent Shares Outstanding 8,886	9,352	9,217	9,093	9,026	
<hr/> <hr/>					
Selected Balance Sheet Data					
Total Assets 40,245	\$ 67,596	\$ 61,945	\$ 54,799	\$ 46,105	\$
Property, Plant and Equipment, Net 5,513	8,965	8,658	8,132	5,883	
Working Capital 24,401	35,906	29,039	22,420	20,283	

Net Assets of Discontinued Operations	537	9,255	8,033	5,218
2,926				
Assets of Businesses Transferred Under				
Contractual Arrangements			593	1,001
1,302				
Stockholders' Equity	59,015	54,076	45,566	40,365
34,751				

</TABLE>

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

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 8 telephone companies (the seven Regional Bell Operating Companies (RBOCs) and GTE) 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.

1995 Compared to 1994

Revenues from continuing operations increased 16% to \$66,004,000. Operating income from continuing operations increased 26% to \$10,189,000. Sales to customers in the U.S. increased 18% to \$49,192,000. Sales to the Big 8 telephone companies increased 25% and accounted for 64% of U.S. customer sales. Sales to distributors, OEMs, and electrical contractors increased 7%. Sales to retail customers increased 1%. Sales to international customers from the Company's U.S. plants, including sales to Canada, increased 46% to \$3,059,000. The sales increases were generated by increased sales of the Company's CorroShield line of corrosion resistant connectors. CorroShield sales increased 123% to \$14,683,000 in 1995, accounting for 30% of all U.S. shipments.

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Sales by Austin Taylor increased \$520,000, or 4%. The sales increase was due to increased sales of cable television products in the U.K. market, where cable

television is still a young industry. Sales of these products offset the loss to competitors of a number of sales contracts with British Telecom for line jacks and modular boxes. Sales to U.K. customers accounted for 79% of Austin Taylor's 1995 sales.

Gross margins on sales were \$18,707,000 in 1995, up 15% from \$16,265,000 in 1994. Gross margin as a percentage of sales was 28% compared to 29% in 1994. Gross margin in U.S. plants was unchanged from 1994 levels. Austin Taylor's margins declined slightly due to increased labor and depreciation charges.

Selling, general and administrative expenses increased \$339,000 or 4%. The increase was due to higher administration and distribution costs in the U.K., which increased \$489,000 or 34%. U.S. apparatus selling and administrative expenses increased \$63,000 or 1%. General corporate expenses declined \$252,000 or 21%.

Investment income, net of interest expense, increased \$558,000 due to higher interest earnings on invested funds and increased marketable securities valuations.

Income from continuing operations before income taxes increased \$2,661,000 or 32%. The Company's effective income tax rate was 19.5% compared to 19.2% in 1994. The increase in the tax rate was due to taxes accrued on the Company's foreign earnings. Income from continuing operations increased \$2,113,000 or 31%

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 in 1996 were \$4,789,000. ATC's operating income in 1996 was \$129,000.

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.

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Liquidity and Capital Resources

At December 31, 1996, the Company had approximately \$17,799,000 of cash and cash equivalents compared to \$11,704,000 of cash and cash equivalents at December 31, 1995. The Company had working capital of approximately \$35,906,000 and a current ratio of 5.2 to 1 compared to working capital of \$29,039,000 and a current ratio of 4.7 to 1 at the end of 1995.

Cash flow provided by operations was approximately \$10,572,000 in 1996 compared to \$6,913,000 in 1995. The increase was due to the Company's ability to maintain its product sales levels while decreasing inventory stocks by \$1,566,000. Accounts receivable increased \$1,484,000 due to the Company's increased levels of business over the second half of 1996. Investing activities provided \$861,000 in cash in 1996 as cash flows from discontinued Zercom operations more than offset cash invested in new plant and equipment and the acquisition of Automatic Tool and Connector Co. The Company expects to spend \$2,500,000 on capital

additions in 1997.

Cash used in financing activities increased to \$5,470,000. 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. At December 31, 1996, the Company had purchased and retired 255,495 common shares under this authorization, at a cost of \$3,263,000. The Company intends to purchase and retire additional shares 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 \$352,000, \$272,000 and \$209,000 in 1996, 1995 and 1994, 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 1996 at the full U.S. rate, income tax expense would have increased by \$1,908,000.

At December 31, 1996 approximately \$30,134,000, \$2,818,000, and \$88,000 of working capital 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, 1996, the Company's 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.

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Changes in Accounting Standards

Effective January 1, 1996, the Company has adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". This statement requires that assets to be held and used be reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss should be recognized when the estimated future cash flows from the asset are less than the carrying value of the asset. Assets to be disposed of should be reported at the lower of their carrying amount or fair value less cost to sell. Adoption of this statement did not have a material effect on the Company's results of operations or financial position.

Effective January 1, 1996, the Company adopted Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation". This statement requires the Company to disclose the fair value of stock-based compensation to employees. The Company has elected to continue to apply APB Opinion No. 25, "Accounting for Stock Issued to Employees" for measurement and recognition of stock-based transactions with its employees, but will disclose pro forma information in accordance with SFAS 123.

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 and the investing public, the Company may make statements regarding the Company's future financial performance. Such forward looking statements are subject to risks and uncertainties, including but not limited to buying patterns of Regional 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 the Company's subsidiary in Puerto Rico and other risks involving the telecommunications industry generally.

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, 1996 and 1995 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, 1996. Our audits also include the financial statement schedule listed in the Index at Item 14. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 1996 and 1995 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1996 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 21, 1997
Minneapolis, Minnesota

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

March 27, 1997

Paul N. Hanson
Chief Financial Officer

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<TABLE>
<CAPTION>

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

December 31

	1996	1995
<hr/>		
CURRENT ASSETS:		
<S>	<C>	<C>
Cash and cash equivalents	\$ 17,799,398	\$ 11,703,536
Marketable securities (Note 3)	889,782	899,469
Trade accounts receivable, less allowance for doubtful accounts of \$306,000 and \$288,000 respectively	10,682,546	8,501,117
Inventories (Note 4)	13,861,914	
14,828,534		
Prepaid expenses	460,692	
345,004		
Deferred income taxes (Note 9)	792,000	630,000
	<hr/>	
TOTAL CURRENT ASSETS	44,486,332	
36,907,660		
PROPERTY, PLANT AND EQUIPMENT, net (Notes 1 and 5)	8,964,590	8,658,020
NET ASSETS OF DISCONTINUED OPERATIONS (Note 2)	536,679	9,255,016
OTHER ASSETS:		
Excess of cost over net assets acquired (Note 1)	3,166,422	659,264
Investments in mortgage backed and other securities (Notes 1 and 3)	4,487,934	5,398,316
Note receivable from sale of assets of discontinued contract manufacturing operations (Note 2)	4,866,597	
Deferred income taxes (Note 9)	835,047	593,047
Other assets	252,513	
473,285		
	<hr/>	
TOTAL OTHER ASSETS	13,608,513	
7,123,912		
	<hr/>	
TOTAL ASSETS	\$ 67,596,114	\$
61,944,608		
	<hr/>	
	<hr/>	

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Notes payable		\$
66,715		
Accounts payable	\$ 3,164,406	
3,181,684		
Accrued expenses	2,622,853	
1,957,429		
Dividends payable	728,585	
642,838		
Income taxes payable	2,064,792	
2,020,366		
	<hr/>	
TOTAL CURRENT LIABILITIES	8,580,636	7,869,032

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 authorized; 9,107,309 and 9,183,401 shares issued and outstanding respectively (Notes 1 and 8)	455,365	459,170

Additional paid-in capital	21,454,353	19,706,125
Retained earnings	36,856,285	
34,140,435		
Cumulative translation adjustments (Note 1)	249,475	
(230,154)		
<hr/> TOTAL STOCKHOLDERS' EQUITY	<hr/> 59,015,478	<hr/> 54,075,576
<hr/> TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<hr/> \$ 67,596,114	<hr/> \$ 61,944,608

See notes to consolidated financial statements.

</TABLE>

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<TABLE>
<CAPTION>

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31		
	1996	1995	1994
<S>	<C>	<C>	<C>
REVENUES FROM CONTINUING OPERATIONS (Note 10):	\$ 68,704,940	\$ 66,004,316	\$ 57,077,350
COSTS AND EXPENSES:			
Cost of sales	47,718,676	47,297,078	40,812,200
Selling, general and administrative expenses	10,581,557	8,518,644	8,179,492
TOTAL COSTS AND EXPENSES	<hr/> 58,300,233	<hr/> 55,815,722	<hr/> 48,991,692
OPERATING INCOME FROM CONTINUING OPERATIONS	10,404,707	10,188,594	8,085,658
OTHER INCOME AND (EXPENSES):			
Investment income	808,287	917,037	448,537
Interest expense	(9,139)	(17,806)	(107,605)
OTHER INCOME, net	<hr/> 799,148	<hr/> 899,231	<hr/> 340,932
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	11,203,855	11,087,825	8,426,590
INCOME TAX EXPENSE (Note 9)	2,250,000	2,164,000	1,616,000
INCOME FROM CONTINUING OPERATIONS	<hr/> 8,953,855	<hr/> 8,923,825	<hr/> 6,810,590
DISCONTINUED OPERATIONS (Note 2):			
Income (loss) from operations of discontinued contract manufacturing operations, net of income taxes	(719,218)	160,328	(6,960)
Loss on disposal of assets of contract manufacturing operations, net of income taxes	(2,106)		
NET INCOME	<hr/> \$ 8,232,531	<hr/> \$ 9,084,153	<hr/> \$ 6,803,630
NET INCOME PER COMMON AND COMMON EQUIVALENT SHARE (Note 1):			
Continuing Operations	\$.96	\$.97	\$.75
Discontinued Operations	(.08)	.02	-
NET INCOME PER SHARE	<hr/> \$.88	<hr/> \$.99	<hr/> \$.75
AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING (Notes 1 and 8)	<hr/> 9,352,000	<hr/> 9,217,000	<hr/> 9,093,000

See notes to consolidated financial statements.

common stock (3,262,683)	(255,495)	(12,775)	(601,381)	(2,648,527)		
Cumulative translation adjustment 479,629	479,629					
<u>BALANCE AT DECEMBER 31, 1996</u> 249,475	<u>9,107,309</u>	<u>\$ 455,365</u>	<u>\$21,454,353</u>	<u>\$36,856,285</u>	<u>\$</u>	<u>-</u>
\$59,015,478						\$

See notes to consolidated financial statements.

</TABLE>

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<TABLE>
<CAPTION>

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

	Year Ended December 31	
	1996	1995
1994		
CASH FLOWS FROM OPERATING ACTIVITIES:		
<S>	<C>	<C>
<C>		
Net income	\$ 8,232,531	\$ 9,084,153
\$ 6,803,630		
Discontinued operations	721,324	(160,328)
6,960		
Income from continuing operations	8,953,855	8,923,825
6,810,590		
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	2,303,303	1,995,352
1,709,011		
Deferred taxes	(405,880)	(22,000)
(270,000)		
Adjustment to marketable securities reserve	9,687	(90,046)
113,297		
Changes in assets and liabilities net of effects from acquisitions and discontinued operations:		
Decrease in marketable securities		81,001
165,000		
Decrease (increase) in accounts receivable	(1,483,853)	1,603,613
(3,223,683)		
Decrease (increase) in inventory	1,565,972	(4,240,940)
474,887		
Decrease (increase) in prepaid expenses	(99,921)	97,456
(76,239)		
Increase (decrease) in accounts payable	(925,127)	(503,139)
981,799		
Increase (decrease) in accrued expenses	617,793	(479,097)
1,305,449		
Increase (decrease) in income taxes payable	36,534	(452,939)
917,914		
Total adjustments	1,618,508	(2,010,739)
2,097,435		
Net cash provided by operating activities	10,572,363	6,913,086
8,908,025		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(1,989,053)	(2,496,488)
(3,026,073)		
Sales (purchases) of mortgage backed and other investment securities	909,598	(87,181)
30,922		
Sales (purchases) of other assets	218,630	(150,475)
79,715		
Collections from businesses transferred under contractual arrangements		564,657
408,079		

Cash receipts from sale of assets of discontinued operations	1,500,000	
Changes in assets and liabilities of discontinued operations (2,779,760)	1,630,416	(1,062,021)
Collections from (advances to) Hector Communications Corporation 348,055		
Payment for purchase of Austin Taylor Communications, Ltd., net of cash acquired (280,944)	(135,131)	
Payment for purchase of Automatic Tool and Connector Co., Inc., net of cash acquired	(1,273,776)	
<hr/> Net cash provided by (used in) investing activities (5,220,006)	<hr/> 860,684	<hr/> (3,231,508)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of notes payable and long-term debt (177,962)	(65,557)	(152,508)
Dividends paid (1,970,830)	(2,782,407)	(2,360,025)
Proceeds from issuance of notes payable and long-term debt 213,279		
Proceeds from issuance of common stock 343,577	640,270	1,934,979
Purchase of Communications Systems, Inc. common stock	(3,262,683)	(220,332)
Repayments from Employee Stock Ownership Plan 122,000		72,000
<hr/> Net cash used in financing activities (1,469,936)	<hr/> (5,470,377)	<hr/> (725,886)
<hr/> EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH 22,295	<hr/> 133,192	<hr/> 1,774
<hr/> NET INCREASE IN CASH AND CASH EQUIVALENTS 2,240,378	<hr/> 6,095,862	<hr/> 2,957,466
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR 6,505,692	11,703,536	8,746,070
<hr/> CASH AND CASH EQUIVALENTS AT END OF YEAR \$ 8,746,070	<hr/> \$ 17,799,398	<hr/> \$ 11,703,536
<hr/> SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Income taxes paid	\$ 2,137,401	\$ 2,664,962
\$ 968,009		
Interest paid 35,318	9,139	17,806

See notes to consolidated financial statements.

</TABLE>

COMMUNICATIONS SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 1996, 1995 and 1994

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.

The Company currently leases, with option to purchase, the building housing ATC's manufacturing and sales operations from ATC's former owners. Payments under the lease were \$129,600 in 1996, which the Company believes to be the building's fair market rental. The lease expires December 31, 1997. If, at the expiration of the lease, the Company does not exercise its purchase option, an additional payment of \$100,000 will be due to ATC's former owners.

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 \$307,000 and \$209,000 at December 31, 1996 and 1995, 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 \$1,927,081, \$1,950,563, and \$1,672,607 for 1996, 1995 and 1994, 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 \$376,222, \$44,789 and \$36,404 in 1996, 1995 and 1994, respectively.

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Line of credit: The Company has a commitment from First Bank of Minneapolis in the form of a \$2,000,000 line of credit.

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. Gains or losses from currency exchange transactions during the periods were not material.

Net income per common and common equivalent share: Net income per common and common equivalent share is based on the weighted average number of common and common equivalent shares outstanding during each year. Common equivalent shares reflect the dilutive effect of outstanding stock options. Primary and fully diluted earnings per share are substantially the same.

Changes in accounting principles: Effective January 1, 1996, the Company adopted the disclosure provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (Note 8). The Company has elected to continue to follow the guidance of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" for measurement and recognition of stock-based transactions with employees.

Effective January 1, 1996, the Company adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". This statement requires that assets to be held and used be reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss should be recognized when the estimated future cash flows from the asset are less than the carrying value of the asset. Assets to be disposed of should be reported at the lower of their carrying amount of fair value less cost to sell. Adoption of this statement did not have a material effect on the Company's operating results or financial position.

Effective January 1, 1995, the Company adopted Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments". The Statement extends existing fair value disclosure practices by requiring all entities to disclose the fair value of financial instruments, both assets and liabilities, recognized and not recognized in the balance sheet, for which it is practical to estimate fair value. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The Company's cash, accounts receivable, accounts payable, accrued liabilities and other liabilities are carried at amounts which reasonably approximate their fair value due to their short term nature. Fair values of investments in debt and equity securities are disclosed in Note 3.

Change of presentation: Certain amounts in the 1995 and 1994 financial statements have been reclassified to conform with the 1996 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 Company's consolidated financial statements and accompanying notes have been restated to present separately the net assets and results of operations of the discontinued operations. Operating results of the discontinued contract operations were as follows:

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<TABLE>
<CAPTION>

	Ten Months Ended October 31 1996	Year Ended December 31 1995	Year Ended December 31 1994
<S>	<C>	<C>	<C>
Sales	\$ 13,517,501	\$ 19,953,130	\$ 17,714,022
Costs and expenses	14,684,080	19,697,551	17,689,286
Interest income, net	35,361	40,749	2,304
Income (loss) before income taxes	(1,131,218)	296,328	27,040
Income tax expense (benefit)	(412,000)	136,000	34,000
Income (loss) from operations	(719,218)	160,328	(6,960)
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	\$ (6,960)

</TABLE>

<TABLE>
<CAPTION>

Net assets of discontinued operations consisted of the following:

	Year Ended December 31 1996	Year Ended December 31 1995
<S>	<C>	<C>
Property, plant and equipment		\$ 2,257,288
Inventory		4,694,429
Other working capital	\$ 267,679	1,957,334
Deferred income taxes	269,000	107,000
Intangible assets		238,965
Net assets of discontinued operations	536,679	9,255,016

</TABLE>

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:

<TABLE>

<CAPTION>

	December 31	
	1996	1995
<S>	<C>	<C>
Aggregate cost	\$ 963,297	\$ 963,297
Valuation allowance	(73,515)	(63,828)
Aggregate market value	\$ 889,782	\$ 899,469

</TABLE>

Investment income (loss) includes (\$9,687), \$90,046 and (\$113,297) for changes in the unrealized holding gains and losses in 1996, 1995 and 1994, respectively. Investment income also includes gain on sales of marketable securities of \$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, 1996 the amortized cost basis of the securities was \$4,379,000. Market value of the securities was \$4,337,000 resulting in a gross unrealized holding loss of \$42,000, which is not reflected in the financial statements.

The Company has an investment in convertible bonds issued by Hector Communications Corporation (Note 1). The bonds mature in 2002 and the Company is holding them to maturity. Amortized cost of the bonds was \$109,000 which approximates their market value.

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NOTE 4 - INVENTORIES

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

<TABLE>

<CAPTION>

	December 31	
	1996	1995
<S>	<C>	<C>
Finished goods	\$ 3,957,655	\$ 4,231,990
Raw and processed materials	9,904,259	10,596,544
	\$ 13,861,914	\$ 14,828,534

</TABLE>

NOTE 5 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment and the estimated useful lives are as follows:

<TABLE>

<CAPTION>

		December 31	
	Estimated useful life	1996	1995
<S>	<C>	<C>	<C>
Land		\$ 292,619	\$ 276,669
Buildings	7-30 years	2,905,108	2,832,593
Machinery and equipment	3-15 years	19,119,653	17,444,643
Furniture and fixtures	5-10 years	1,982,324	1,741,299
		24,299,704	22,295,204
Less accumulated depreciation		15,335,114	13,637,184
		\$ 8,964,590	\$ 8,658,020

</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 1996, 1995 and 1994 were \$73,000, \$77,000, and \$71,000 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 \$603,000, \$454,000 and \$469,000 in 1996, 1995 and 1994 respectively.

At December 31, 1996, the Company was obligated under noncancellable operating leases to make minimum annual future lease payments as follows:

<TABLE>
<CAPTION>

Year Ended December 31:	<C>
<S>	<C>
1997	\$ 402,000
1998	233,000
1999	255,000
2000	266,000
2001	266,000
After 2001	620,000

	\$ 2,042,000
	=====

</TABLE>

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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, 1996, 315,417 shares remained available to be issued under the plan. Options granted to key employees in 1995 and 1996 are subject to vesting. One third of the options issued vest immediately, the remaining two thirds vest equally over the next two years. All 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. At December 31, 1996, 102,000 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, 1996 is as follows:

<TABLE>
<CAPTION>

	Number of shares	Average exercise price per share
<S>	<C>	<C>
Outstanding at December 31, 1993	336,700	\$ 7.08
Granted	149,600	11.93
Exercised	(27,000)	7.87
Canceled	(1,600)	7.53
	-----	-----
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	435,422	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
	=====	=====

</TABLE>

At December 31, 1996, 400,565 shares of outstanding options are currently exercisable. The following table summarizes the status of Communications Systems, Inc. stock options outstanding at December 31, 1996:

<TABLE>
<CAPTION>

Range of Exercise Prices	Shares	Weighted Average Remaining Option Life	Weighted Average Exercise Price
<C>	<C>	<C>	<C>

\$ 5.31 to \$ 9.99	136,117	1.8 years	\$ 7.87
\$10.00 to \$14.99	348,572	3.5 years	13.60
\$15.00 to \$15.95	57,000	6.3 years	15.70

</TABLE>

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 of not more than 10% of compensation. 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 to the acquisition in any plan year to the number of shares which their payroll deductions for the year would purchase based on the market price on the first day of the year or \$25,000, whichever is less. Shares issued to employees under the plan were 14,346, 23,567 and 15,408 for the plan years ended August 31, 1996, 1995 and 1994, respectively. At December 31, 1996 employees had subscribed to purchase an additional 17,800 shares in the current plan cycle ending August 31, 1997.

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, net income and earnings per share would have been as follows:

	Year Ended December 31	
	1996	1995
Net Income	\$ 7,740,304	\$ 8,774,114
Net Income Per Share	\$.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 1996 and 1995: 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 \$492,000 and \$310,000 in 1996 and 1995, respectively. The fair value of all options issued in 1996 and 1995 was \$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. All advances by the Company to the ESOP were repaid at December 31, 1996.

At December 31, 1996, the ESOP held 339,441 shares of the Company's common stock, all of which has been allocated to the accounts of eligible employees. All eligible employees of the Company participate in the plan 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.

Contributions to the plan are determined by the Board of Directors and can be made in cash or shares of the Company's stock. Contributions of \$72,000 and \$122,000 of cash were made in the years ending December 31, 1995 and 1994, respectively. 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.

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. At December 31, 1996, the Company had 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 \$1.71 U.S. per share at December 31, 1996). 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, 1996, 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 \$1.36 per share.

NOTE 9 - INCOME TAXES

Income tax expense from continuing operations consists of the following:

<TABLE>
<CAPTION>

	Year Ended December 31		
	1996	1995	1994
Currently payable income taxes:			
<S>	<C>	<C>	<C>
Federal	\$ 1,444,000	\$ 759,000	\$ 966,000
State	294,000	105,000	120,000
Puerto Rico	646,000	589,000	568,000
Canada	10,000	40,000	17,000
United Kingdom	247,000	450,000	215,000
	2,641,000	1,943,000	1,886,000
Tax effect of disqualified employee incentive stock options	13,000	243,000	
Deferred income tax benefit	(404,000)	(22,000)	(270,000)
	\$ 2,250,000	\$ 2,164,000	\$ 1,616,000

=====

</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 \$352,000, \$272,000 and \$209,000 of U.S. federal income tax expense on earnings in Puerto Rico for 1996, 1995 and 1994, 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 \$14,766,000 at December 31, 1996.

Suttle Apparatus Canada, Ltd., is subject to Canadian rather than U.S. income taxes. Canadian pretax income was \$21,000, \$80,000 and \$31,000 for 1996, 1995 and 1994, 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 \$791,000, \$1,450,000 and \$1,872,000 in 1996, 1995 and 1994, 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

	1996	1995	1994
<S>	<C>	<C>	<C>
Tax at U.S. statutory rate	35.0%	35.0%	35.0%
Surtax exemption	(1.0)	(1.0)	(1.0)
U.S. taxes not provided on Puerto Rico operations	(17.0)	(18.3)	(15.4)
State income taxes, net of federal benefit	1.7	1.0	.5
Other	1.4	2.8	.1
Effective tax rate	20.1%	19.5%	19.2%

</TABLE>

Deferred tax assets and liabilities as of December 31 related to the following:

	1996	1995
<S>	<C>	<C>
Current assets:		
Marketable securities	\$ 26,000	\$ 24,000
Bad debts	73,000	75,000
Inventory	365,000	274,000
Accrued expenses	328,000	257,000
	\$ 792,000	\$ 630,000
Long term assets and (liabilities):		
Depreciation	\$ (232,953)	\$ (195,953)
Loss reserves on notes receivable	130,000	126,000
Alternative minimum tax credits	938,000	663,000
	\$ 835,047	\$ 593,047

</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:

	Telephone Station Apparatus				
	U.S.	U.K.	Other	Corporate	Eliminations
Consolidated					
Year Ended December 31, 1996:					
Revenues:					
<S>	<C>	<C>	<C>	<C>	<C>
<C>					
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								

=====

Year Ended December 31, 1994:

Revenues:

Sales to unaffiliated customers	\$	42,968,330	\$	13,233,582	\$	875,438		
\$ 57,077,350								
Transfers between geographic areas		707,835				1,661,986		\$
(2,369,821)								

Total	\$	43,676,165	\$	13,233,582	\$	2,537,424		\$
(2,369,821) \$ 57,077,350								

=====

Operating Income	\$	7,230,961	\$	1,884,504	\$	140,842	\$	(1,170,649)
\$ 8,085,658								

=====

Identifiable Assets	\$	32,976,104	\$	6,892,512	\$	1,598,255	\$	13,332,582
\$ 54,799,453								

=====

Depreciation and Amortization	\$	1,120,740	\$	316,814	\$	137,223	\$	134,234
\$ 1,709,011								

=====

Capital Expenditures	\$	2,132,196	\$	1,325,219	\$	83,165	\$	295,493
\$ 3,836,073								

=====

Export sales were less than 10% of consolidated revenues in each of the last three years. At December 31, 1996, foreign earnings in excess of amounts received in the United States were approximately \$5,748,000.

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. In 1994, sales to one U.S. customer amounted to 15.1% of consolidated revenues.

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

1996				
<S>	<C>	<C>	<C>	<C>
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

Net Income (Loss) Per Share:				
Continuing Operations	\$.21	\$.18	\$.26	\$.31
Discontinued Operations	.01	(.04)	(.05)	
Net Income Per Share	\$.22	\$.14	\$.21	\$.31
=====				
1995				
Revenues from Continuing Operations	\$ 18,022	\$ 16,594	\$ 16,441	\$ 14,947
Gross Margins	5,216	4,020	4,710	4,761
Operating income from Continuing Operations	2,799	2,427	2,625	2,338
Income from Continuing Operations	2,375	2,113	2,200	2,236
Income (Loss) from Discontinued Operations	146	184	(45)	(125)
Net Income	2,521	2,297	2,155	2,111

Net Income (Loss) Per Share:				
Continuing Operations	\$.26	\$.23	\$.24	\$.24
Discontinued Operations	.02	.02	(.01)	(.01)
Net Income Per Share	\$.28	\$.25	\$.23	\$.23
=====				

</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 22, 1997 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 22, 1997 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 22, 1997 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 22, 1997 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.

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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 14 to 29 herein:

Independent Auditors' Report for the years ended
December 31, 1996, 1995 and 1994

Consolidated Balance Sheets as of December 31, 1996 and 1995

Consolidated Statements of Income for the years ended
December 31, 1996, 1995 and 1994

Consolidated Statements of Changes in Stockholders' Equity for the
years ended December 31, 1996, 1995 and 1994

Consolidated Statements of Cash Flows for the years ended
December 31, 1996, 1995 and 1994

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 on financial statements
and schedule for the years ended
December 31, 1996, 1995 and 1994 14

Schedule II - Valuation and Qualifying Accounts and Reserves 34

All other schedules are omitted as the required information is inapplicable or the information is presented in the 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, 1996

The Company's filed a Form 8-K Report dated November 18, 1996, which, as amended by a Form 8 amendment filed November 19, 1996, reported the sale of the assets of Zercom Corporation under Item 2, "Acquisition or Disposition of Assets" and related financial information under Item 7, "Financial Statements and Exhibits".

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, 1997

/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, 1997
/s/ Paul N. Hanson ----- Paul N. Hanson	Vice President, Treasurer and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 27, 1997
----- Paul J. Anderson	Director	March 27, 1997
----- Edwin C. Freeman	Director	March 27, 1997
/s/ Frederick M. Green ----- Frederick M. Green	Director	March 27, 1997
/s/ John C. Ortman ----- John C. Ortman	Director	March 27, 1997
/s/ Joseph W. Parris ----- Joseph W. Parris	Director	March 27, 1997
/s/ Wayne E. Sampson ----- Wayne E. Sampson	Director	March 27, 1997
/s/ Edward E. Strickland ----- Edward E. Strickland	Director	March 27, 1997

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, 1996

FINANCIAL STATEMENT SCHEDULE

33

<TABLE>
<CAPTION>

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

Balance at at End Description of Period	Balance at Beginning of Period	Additions Charged to Cost and Expenses	Additions Charged to Other Accounts	Deductions from Reserves
Allowance for doubtful accounts:				
Year ended:				
<S> <C> December 31, 1996 \$ 306,000	<C> \$ 288,000	<C> \$ 91,000	<C> \$ -	<C> \$ 73,000 (A)
December 31, 1995 \$ 288,000	\$ 275,000	\$ 60,000	\$ -	\$ 47,000 (A)
December 31, 1994 \$ 275,000	\$ 255,000	\$ 68,000	\$ -	\$ 48,000 (A)
Inventory valuation reserves:				
Year ended:				
December 31, 1996 \$ 1,370,000	\$ 1,262,000	\$ 108,000	\$ -	\$ -
December 31, 1995 \$ 1,262,000	\$ 1,262,000	\$ -	\$ -	\$ -
December 31, 1994 \$ 1,262,000	\$ 1,062,000	\$ 200,000	\$ -	\$ -
Reserve for assets transferred under contractual arrangements:				
Year Ended:				
December 31, 1996 \$ 358,000	\$ 335,000	\$ -	\$ 23,000 (B)	\$ -
December 31, 1995 \$ 335,000	\$ 377,000	\$ -	\$ 43,000 (B)	\$ 85,000
December 31, 1994 \$ 377,000	\$ 288,000	\$ -	\$ 89,000 (B)	\$ -

(A) Accounts determined to be uncollectible and charged off against reserve.
(B) 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, 1996

EXHIBITS

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
Exhibit Index To
Form 10-K for the Year Ended December 31, 1996

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 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.

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<TABLE>
<CAPTION>

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

	Year Ended December 31		
	1996	1995	1994
Primary:			
<S>	<C>	<C>	<C>
Income from continuing operations	\$ 8,953,855	\$ 8,923,825	\$ 6,810,590
Income (loss) from discontinued operations	(721,324)	160,328	(6,960)
Net income	\$ 8,232,531	\$ 9,084,153	\$ 6,803,630
	=====	=====	=====
Common and common equivalent shares (1):			
Weighted average number of common shares outstanding	9,272,825	9,097,771	8,962,491
Dilutive effect of stock options outstanding after application of treasury stock method	79,175	119,229	130,509
	9,352,000	9,217,000	9,093,000
	=====	=====	=====
Primary net income (loss) per common and common equivalent share (1):			
Continuing operations	\$.96	\$.97	\$.75
Discontinued operations	(.08)	.02	-
Net income per share	\$.88	\$.99	\$.75
	=====	=====	=====
Fully Diluted:			
Income from continuing operations	\$ 8,953,855	\$ 8,923,825	\$ 6,810,590
Income (loss) from discontinued operations	(721,324)	160,328	(6,960)
Net income	\$ 8,232,531	\$ 9,084,153	\$ 6,803,630
	=====	=====	=====
Common and common equivalent shares (1):			
Weighted average number of common shares outstanding	9,272,825	9,097,771	8,962,491
Dilutive effect of stock options outstanding after application of treasury stock method	97,175	129,229	150,509
	9,370,000	9,227,000	9,113,000
	=====	=====	=====
Fully diluted net income (loss) per common and common equivalent share (1):			
Continuing operations	\$.96	\$.96	\$.75
Discontinued operations	(.08)	.02	-
Net income per share	\$.88	\$.98	\$.75
	=====	=====	=====

(1) Primary and fully diluted earnings per share are substantially the same. The dilutive effect of stock options under the fully diluted calculation for each year is greater due to the end of the year closing price exceeding the average

</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 21, 1997 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, 1996.

/s/ Deloitte & Touche LLP
Deloitte & Touche LLP
March 27, 1997
Minneapolis, Minnesota

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