

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 1995

OR

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

For the transition period from to

Commission file number 0-10355

COMMUNICATIONS SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Minnesota 41-0957999

(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)

213 South Main, Hector, MN 55342

(Address of principle executive offices) (Zip Code)

(612) 848-6231

(Registrant's telephone number, including zip code)

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	Outstanding at July 31, 1995
-----	-----
Common Stock, par value \$.05 per share	9,143,143

Total Pages (11) Exhibit Index at (NO Exhibits)  
COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

Item 1. Financial Statements

<TABLE>

<CAPTION>

CONSOLIDATED BALANCE SHEETS  
(unaudited)

<S>	<C> June 30 1995	<C> December 31 1994
Assets:		
Current assets:		
Cash	\$9,294,658	\$8,829,776
Marketable securities	971,346	890,424
Receivables, net	13,500,153	12,535,306
Inventories - Note 2	16,349,485	16,190,879
Prepaid expenses	418,559	492,554
Deferred income taxes	1,108,000	1,108,000
	-----	-----
Total current assets	41,642,201	40,046,939
Property, plant and equipment	25,467,061	22,977,540
less accumulated depreciation	(13,955,102)	(12,707,397)
	-----	-----
Net property, plant and equipment	11,511,959	10,270,143
Assets of businesses transferred under contractual arrangements (notes receivable)	420,618	592,838
Other assets:		
Investments in mortgage backed and other securities	5,296,759	5,300,841
Excess of cost over net assets acquired	744,679	785,364
Deferred income taxes	376,047	376,047
Other assets	409,972	380,825
	-----	-----
Total other assets	6,827,457	6,843,077
	-----	-----
Total Assets	\$60,402,235	\$57,752,997
	=====	=====
Liabilities and Stockholders' Equity:		
Current liabilities:		
Notes payable and current portion of long-term debt	\$328,158	\$421,273
Accounts payable	4,541,892	5,843,729
Accrued expenses	2,825,222	2,833,987
Dividends payable	637,399	539,191
Income taxes payable	1,707,625	2,481,145
	-----	-----
Total current liabilities	10,040,296	12,119,325
	=====	=====
Long-term debt	68,498	67,231
Stockholders' Equity	50,293,441	45,566,441
	-----	-----
Total Liabilities and Stockholders' Equity	\$60,402,235	\$57,752,997
	=====	=====

</TABLE>

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME  
(unaudited)

<TABLE>  
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	Three Months Ended June 1995	1994	Six Months Ended June 30 1995	1994
<S>	<C>	<C>	<C>	<C>
Revenues:				
Sales	\$21,866,017	\$18,301,256	\$46,671,964	\$36,914,676
Costs and expenses:				
Cost of sales	17,003,442	13,807,086	35,760,644	27,783,979
Selling, general and administrative expenses	2,149,999	2,686,934	5,166,773	5,285,004
Total costs & expenses	19,151,44	16,494,020	40,927,417	33,068,983
Operating income	2,714,576	1,807,236	5,744,547	3,845,693
Other income and (expenses)				
Investment income	216,353	60,476	521,063	198,901
Interest expense	(14,242)	(11,196)	(27,921)	(28,204)
Other income, net	202,111	49,280	493,142	170,697
Income before income taxes	2,916,687	1,856,516	6,237,689	4,016,390
Income taxes (Note 3)	620,000	330,000	1,420,000	780,000
Net income	\$2,296,687	\$1,526,516	\$4,817,689	\$3,236,390
Net income per share	\$ .25	\$ .17	\$ .53	\$ .36
Average common and common equivalent shares outstanding ..	9,232,000	9,087,000	9,171,000	9,095,000

</TABLE>

See notes to consolidated financial statements.

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

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	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Retained Earnings	Advances to ESOP	Cumulative Translation Adjustment
<S>	<C>	<C>	<C>	<C>	<C>	<C>
BALANCE at December 31, 1993 ...	8,944,115	\$447,206	\$17,659,865	\$22,779,139	(\$194,000)	(\$327,163)
\$40,365,047						
Net Income				6,803,630		
6,803,630						
Shareholder dividends				(2,062,815)		
(2,062,815)						
Issuance of common stock under Employee Stock Purchase Plan	15,408	770	130,198			
130,968						
Issuance of common stock under Employee Stock Option Plan	27,000	1,350	211,259			
212,609						
Repayment of advances to Employee Stock Ownership Plan					122,000	
122,000						
Cumulative translation adjustment						(4,998)
(4,998)						
-----						
BALANCE at December 31, 1994 .....	8,986,523	449,326	18,001,322	27,519,954	(72,000)	(332,161)
45,566,441						
Net Income				4,817,689		
4,817,689						
Shareholder dividends				(1,178,849)		
(1,178,849)						
Issuance of common stock under						

Employee Stock Option Plan	114,466	5,724	859,406			
865,130						
Issuance of common stock to Welsh Development Agency	20,142	1,007	219,325			
220,332						
Advances to Employee Stock Ownership Plan					(220,332)	
(220,332)						
Cumulative translation adjustment						223,030
223,030						
-----	-----	-----	-----	-----	-----	-----
BALANCE at June 30, 1995 .....	9,121,131	\$456,057	\$19,080,053	\$31,158,794	(\$292,332)	(\$109,131)
\$50,293,441	=====	=====	=====	=====	=====	=====

</TABLE>

See notes to consolidated financial statements.

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

<TABLE>  
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	Six Months Ended June 30	
	1995	1994
	<C>	<C>
<S>		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$4,817,689	\$3,236,390
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,275,066	1,053,551
Deferred taxes		257,202
Adjustment to marketable securities reserve	(120,922)	47,843
Changes in assets and liabilities:		
Decrease in marketable securities	40,000	129,275
Increase in accounts receivable	(801,088)	(3,507,178)
Decrease (increase) in inventory	(131,123)	107,902
Decrease in prepaid expenses	76,067	98,868
Decrease in accounts payable	(1,333,139)	(164,515)
Increase (decrease) in accrued expenses	(23,825)	707,832
Decrease in income taxes payable	(773,446)	(342,997)
	-----	-----
Net cash provided by (used in) operating activities	3,025,279	1,624,173
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(2,431,295)	(1,872,836)
Decrease in mortgage backed and other investment securities	11,240	14,110
Decrease (increase) in other assets	(38,827)	196,912
Collections from businesses transferred under contractual arrangements	172,220	196,501
Collections from Hector Communications Corporation		348,055
	-----	-----
Net cash used in investing activities	(2,286,662)	(1,117,258)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of notes payable and long-term debt	(95,833)	(48,156)
Dividends paid	(1,080,641)	
(894,512)		
Proceeds from issuance of notes payable and long-term debt		169,554
Proceeds from issuance of common stock	1,085,462	81,000
Advances to Employee Stock Ownership Plan	(220,332)	
	-----	-----
Net cash used in financing activities	(311,344)	(692,114)
	-----	-----
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	37,609	8,020
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	464,882	(177,179)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	8,829,776	6,598,139
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$9,294,658	\$6,420,960

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Income taxes paid	\$2,193,520	\$863,997
Interest paid	27,921	28,204

See notes to consolidated financial statements.

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS

The balance sheet and statement of stockholders' equity as of June 30, 1995, the statements of income for the three and six month periods ended June 30, 1995 and 1994 and the statements of cash flows for the six month periods ended June 30, 1995 and 1994 have been prepared by the company without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows at June 30, 1995 and 1994 have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's December 31, 1994 Annual Report to Shareholders. The results of operations for the periods ended June 30, 1995 and 1994 are not necessarily indicative of the operating results for the entire year.

NOTE 2 - INVENTORIES

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

	June 30 1995	December 31 1994
Finished Goods	\$4,373,585	\$3,525,693
Raw Materials	11,975,900	12,665,186
	-----	-----
Total	\$16,349,485	\$16,190,879
	=====	=====

NOTE 3 - INCOME TAXES

Income taxes are computed based upon the estimated effective rate applicable to operating results for the full fiscal year. For the periods ended June 30, 1995 and 1994 income taxes do not bear a normal relationship to income before income taxes, primarily because income from Puerto Rican operations are taxed at rates lower than the U.S. rate.

NOTE 4 - NET INCOME PER COMMON SHARE

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

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

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

Six Months Ended June 30, 1995 Compared to  
Six Months Ended June 30, 1994

Consolidated revenues increased \$9,757,000 or 26% from the 1994 period. Telephone station apparatus revenues increased \$7,059,000, or 26%. Apparatus sales to domestic (U.S. and Puerto Rico) customers increased \$5,523,000, or 27%. Sales to the Big 8 telephone companies (the Regional Bell Operating Companies and GTE) increased \$4,202,000 or 36% and accounted for 59% of domestic apparatus sales in the 1995 period. Sales increases to these customers were due to strong sales of the Company's Corroshield line of corrosion resistant products. Sales to electrical distributors and original equipment manufacturers decreased \$59,000 or 2%. Sales to retail customers increased \$754,000 or 30%.

Sales of telephone station apparatus to international customers increased \$1,536,000 or 21% over 1994. Sales by Austin Taylor, the Company's United Kingdom based subsidiary, increased \$1,076,000 or 17%, due to strong sales across the Company's product line. U.S. export sales increased \$390,000 or 55%. Sales in Canada increased \$70,000 or 16%.

Contract manufacturing revenues increased \$2,698,000, or 29%. Sales to Thermo-King, the segment's principal customer, increased \$136,000 over 1994, and accounted for 43% of the segment's sales. Sales of multifunction display units used by a major watercraft manufacturer increased \$1,201,000 or 114%, accounting for 19% of the segment's 1995 sales. Sales of printed circuit board assemblies to a Minnesota original equipment manufacturer added \$655,000 of new business in the period. Sales of the Company's proprietary line of electronic fishing products increased \$392,000, or 75%.

Gross margin as a percentage of apparatus sales was 27%, compared to 28% in the 1994 period. Gains in overhead efficiencies in U.S. plants due to increased production volume were offset by changes in product mix, particularly Corroshield products which the Company sells at lower margins than standard products. Margins earned on Austin Taylor products declined to 19% from 24% in the 1994 period due to increased raw material costs. Gross margin on contract manufacturing sales declined to 14% compared to 15% in 1994 due to inventory reserves established on certain slow-moving inventory items in the 1995 period.

Selling, general and administrative expenses decreased \$118,000 or 2% from the 1994 period. Increased customer delivery charges in the U.S. were offset by lower selling expenses and lower corporate expenses.

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#### COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

Managements' Discussion (continued)

Consolidated operating income increased \$1,899,000 or 49%. Net other income increased \$322,000 from the 1994 period due to gains on sales of marketable securities and increases in the value of the Company's marketable securities portfolio. The Company's effective income tax rate was 23% for the 1995 period compared to 19% in 1994. The Company's tax rate is lower than the full U.S. rate due to tax exemptions and benefits received by the Company's Puerto Rico operations. The Company's tax rate increased in 1995 due to limitations on the possessions tax credit the Company receives against U.S. income taxes on the earnings of its Puerto Rico subsidiary. Net income increased 49%.

#### Three Months Ended June 30, 1995 Compared to Three Months Ended June 30, 1994

Consolidated revenues increased \$3,565,000 or 19% from the 1994 period. Telephone station apparatus revenues increased \$2,374,000, or 17%. Apparatus sales to domestic (U.S. and Puerto Rico) customers increased \$2,008,000, or 20%. Sales to the Big 8 telephone companies (the Regional Bell Operating Companies and GTE) increased \$1,616,000 or 29% and accounted for 55% of domestic apparatus sales in the 1995 period. Sales increases to these customers were due to strong sales of the Company's Corroshield line of corrosion resistant products. Sales to electrical distributors and original equipment manufacturers decreased \$102,000 or 7%. Sales to retail customers increased \$389,000 or 27%.

Sales of telephone station apparatus to international customers increased \$366,000, or 9% over 1994. Sales by Austin Taylor, the Company's United Kingdom based subsidiary, decreased \$169,000 or 5%. U.S. export sales increased \$517,000 or 166% due to sales of Corroshield products to Latin America and Caribbean island customers. Sales in Canada increased \$18,000 or 8%.

Contract manufacturing revenues increased \$1,191,000, or 29%. Sales to Thermo-King, the segment's principal customer, decreased \$690,000, or 28% from 1994, and accounted for 34% of the segment's sales. The sales decline was due to Thermo-King's decision to perform certain manufacturing functions in-house which were previously done by the Company. Sales of multifunction display units used by a major watercraft manufacturer increased \$865,000 or 399%, accounting for 21% of the segment's 1995 second quarter sales. Sales of printed circuit board assemblies to a Minnesota original equipment manufacturer added \$203,000 of new business in the period. Sales of the Company's proprietary line of electronic fishing products increased \$466,000.

Gross margin as a percentage of apparatus sales was 24, compared to 27% in the 1994 period. Gains in overhead efficiencies in U.S. plants due to increased production volume were offset by changes in product mix, particularly Corroshield products which the Company sells at lower margins than standard products. Margins earned on Austin Taylor products declined sharply due to higher raw material costs and lower production volumes. Gross margin on contract manufacturing sales was 16%, unchanged from the 1994 period.

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Managements' Discussion (continued)

Selling, general and administrative expenses decreased \$539,000 from the 1994 period. Lower U.S. apparatus selling costs, lower corporate charges and expense adjustments at Austin Taylor were responsible for the decrease.

Consolidated operating income increased \$907,000 or 50%. Net other income increased \$153,000 from the 1994 period due to increased interest income and increases in the value of the Company's marketable securities portfolio. The Company's effective income tax rate was 21% for the 1995 period compared to 18% in 1994. The Company's tax rate is lower than the full U.S. rate due to tax exemptions and benefits received by the Company's Puerto Rico operations. The Company's tax rate increased in 1995 due to limitations on the possessions tax credit the Company receives against U.S. income taxes on the earnings of its Puerto Rico subsidiary. Net income increased 50%.

Liquidity and Capital Commitments

At June 30, 1995 the Company had approximately \$9,295,000 in cash compared to \$8,830,000 at December 31, 1994. Cash was utilized during the period to finance increases in accounts receivable, finance new plant and equipment and pay dividends and current liabilities. Working capital increased \$3,674,000 from year end to \$31,602,000. The Company's current ratio was 4.1 to 1, compared to 3.3 to 1 at December 31, 1994.

Order input for U.S. apparatus products was \$27,573,000 in the first half of 1995, up 34% from the 1994 period. Shipments to customers during the first half of 1995 were an all-time record. Sales order backlog was \$5,866,000 at June 30, 1995, up substantially from year end but slightly lower than at March 31. The Company has responded to the increased demand by increasing production shifts, working plants overtime, and increasing use of air shipments to reduce production lead times and customer delivery times. The Company is also expanding its use of outside contract manufacturers to increase its manufacturing capacity.

The Company's balance sheet remains strong, with stockholders' equity of \$50,293,000 and long-term debt of only \$68,000. The Company has available a \$2,000,000 bank line of credit. The Company's cash flows from operations exceeded \$7,000,000 in 1994, and totaled \$3,025,000 in the first half of 1995. Management believes, based on the Company's current financial position and projected future expenditures, that sufficient funds are available to meet the Company's anticipated needs.

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

PART II. OTHER INFORMATION

Items 1-3. Not applicable

Item 4. Submission of matters to Vote of Securityholders

The Annual Meeting of the Shareholders of the Registrant was held on May 15, 1995 in Minneapolis, MN. The total number of shares outstanding and entitled to vote at the meeting was 9,024,165 of which 8,603,821 were present either in person or by proxy. Shareholders reelected Board member Curtis A. Sampson (in favor 8,526,475, abstaining 77,346) and elected new Board member Joseph W. Parris (in favor 8,523,777, abstaining 80,044) to three year terms expiring at the 1998 Annual Meeting of Shareholders. Board member James O. Ericson, a director since 1970, did not stand for reelection at the meeting. Directors continuing in office are Edward E. Strickland, Edwin C. Freeman and John C. Ortman (whose terms expire at the 1996 Annual Meeting of Shareholders) and C.A. Anderson, Paul J. Anderson and Wayne E. Sampson (whose terms expire at the 1997 Annual Meeting of Shareholders).

Additionally, shareholders approved an amendment to the Company's Articles of Incorporation, increasing the total number of authorized shares of common stock, par value \$.05 per share, by 15,000,000 shares to a total of 30,000,000 shares (in favor 7,976,232, opposed 530,763, abstaining 96,826). Shareholders also approved an amendment to the Company's 1992 Stock Plan to increase the total number of shares of common stock available for issuance under such plan by 500,000 shares to 900,000 shares (in favor 7,160,937, against 332,821, abstaining 1,110,063). Shareholders also approved an amendment to the Company's Employee Stock Purchase Plan, increasing the total number of common shares available for issuance under the plan from 100,000 shares to 200,000 shares (in favor 7,400,432, against 150,607, abstaining 1,052,782).

Items 5-6. Not applicable

Signatures

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

Communications Systems, Inc.

By Paul N. Hanson  
-----  
Paul N. Hanson  
Vice President and  
Chief Financial Officer

Date: August 11, 1995



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