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

FORM 10-Q

(Mark One)

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

For the quarterly period ended MARCH 31, 1996

OR

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

For the transition period from to

Commission File Number: 0-10355

COMMUNICATIONS SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

MINNESOTA

41-0957999

(State or other jurisdiction of
incorporation or organization)

(Federal Employer
Identification No.)

213 South Main Street, Hector, MN

55342

(Address of principal executive offices)

(Zip Code)

(320) 848-6231

Registrant's telephone number, including area code

(Former name, former address, 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.

Table with 2 columns: CLASS, Outstanding at April 30, 1996. Row 1: Common Stock, par value \$ .05 per share, 9,316,243

Total Pages (10) Exhibit Index at (NO EXHIBITS)

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

INDEX

Table with 2 columns: Page No., Item 1. Financial Information. Sub-items include Consolidated Balance Sheets (3), Consolidated Statements of Income (4), Consolidated Statements of Stockholders' Equity (5), Consolidated Statements of Cash Flows (6), Notes to Consolidated Financial Statements (7), and Item 2. Management's Discussion and Analysis of

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## PART I. FINANCIAL INFORMATION

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(unaudited)

	March 31 1996	December 31 1995
Assets:		
Current assets:		
<S>	<C>	<C>
Cash	\$10,156,199	\$12,198,455
Marketable securities	864,966	899,469
Receivables, net	12,734,117	10,931,382
Inventories - Note 3	21,013,120	19,522,963
Prepaid expenses	465,354	400,778
Deferred income taxes	1,188,000	1,188,000
Total current assets	<u>46,421,756</u>	<u>45,141,047</u>
Property, plant and equipment	26,756,915	25,762,350
less accumulated depreciation	(15,394,211)	(14,847,042)
Net property, plant and equipment	<u>11,362,704</u>	<u>10,915,308</u>
Other assets:		
Investments in mortgage backed and other securities	5,104,437	5,398,316
Excess of cost over net assets acquired	3,504,979	839,229
Deferred income taxes	461,047	461,047
Other assets	452,494	532,285
Total other assets	<u>9,522,957</u>	<u>7,230,877</u>
Total Assets	<u>\$67,307,417</u>	<u>\$63,287,232</u>
Liabilities and Stockholders' Equity:		
Current liabilities:		
Notes payable	\$109,356	\$146,923
Accounts payable	4,526,455	4,104,349
Accrued expenses	2,491,864	2,296,996
Dividends payable	651,575	642,838
Income taxes payable	2,260,819	2,020,550
Total current liabilities	<u>10,040,069</u>	<u>9,211,656</u>
Stockholders' Equity	<u>57,267,348</u>	<u>54,075,576</u>
Total Liabilities and Stockholders' Equity	<u>\$67,307,417</u>	<u>\$63,287,232</u>

See notes to consolidated financial statements.

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

	Three Months Ended March 31	
	1996	1995
Revenues:		
<S>	<C>	<C>
Sales	\$20,459,113	\$24,805,947
Costs and expenses:		

Cost of sales	15,216,811	18,757,202
Selling, general and administrative expenses	2,863,550	3,018,774
Total costs and expenses	<u>18,080,361</u>	<u>21,775,976</u>
Operating income	2,378,752	3,029,971
Other income and (expenses):		
Investment income	147,376	304,710
Interest expense	(6,453)	(13,679)
Other income, net	<u>140,923</u>	<u>291,031</u>
Income before income taxes	2,519,675	3,321,002
Income taxes (Note 4)	475,000	800,000
Net income	<u>\$2,044,675</u>	<u>\$2,521,002</u>
Net income per share	<u>\$ .22</u>	<u>\$ .28</u>
Average common and common equivalent shares outstanding	<u>9,414,000</u>	<u>9,149,000</u>

See notes to consolidated financial statements.

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

Total	Common Shares	Common Stock Amount	Additional Paid in Capital	Retained Earnings	Advances to ESOP	Cumulative Translation Adjustment
<S>	<C>	<C>	<C>	<C>	<C>	<C>
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BALANCE at December 31, 1994	8,986,523	\$449,326	\$18,001,322	\$27,519,954	(\$72,000)	(\$332,161)
\$45,566,441						
Net Income				9,084,153		
9,084,153						
Shareholder dividends				(2,463,672)		
(2,463,672)						
Issuance of common stock under Employee Stock Option Plan	173,311	8,666	1,267,846			
1,276,512						
Tax benefit from nonqualified employee stock options			243,000			
243,000						
Issuance of common stock under Employee Stock Purchase Plan	23,567	1,178	193,957			
195,135						
Issuance of common stock to Welsh Development Agency	20,142	1,007	219,325			
220,332						
Purchase of Communications Systems Inc. common stock	(20,142)	(1,007)	(219,325)			
(220,332)						
Cumulative translation adjustment						102,007
102,007						
Repayment of advances to ESOP					72,000	
72,000						
BALANCE at December 31, 1995	9,183,401	459,170	19,706,125	34,140,435	-	(230,154)
54,075,576						
Net Income				2,044,675		
2,044,675						
Shareholder dividends				(651,575)		
(651,575)						

Issuance of common stock under Employee Stock Option Plan	15,133	757	149,943			
150,700						
Issuance of common stock to acquire Automatic Tool and Connector Co.	112,676	5,634	1,712,675			
1,718,309						
Cumulative translation adjustment (70,337)						(70,337)
<u>BALANCE at March 31, 1996</u>	<u>9,311,210</u>	<u>\$465,561</u>	<u>\$21,568,743</u>	<u>\$35,533,535</u>	<u>-</u>	<u>(\$300,491)</u>
<u>\$57,267,348</u>						

See notes to consolidated financial statements.

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

Ended March 31	Three Months	
	1996	
1995		
<u>CASH FLOWS FROM OPERATING ACTIVITIES:</u>		<C>
<S>		
<C>		
Net income		\$2,044,675
\$2,521,002		
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization		663,299
682,701		
Adjustment to marketable securities reserve		34,503
(96,458)		
Changes in assets and liabilities:		
Decrease in marketable securities		
40,000		
Increase in accounts receivable		(1,331,874)
(1,643,776)		
Decrease (increase) in inventory		(1,069,736)
196,841		
Decrease (increase) in prepaid expenses		(54,495)
62,960		
Decrease in accounts payable		(298,021)
(955,414)		
Increase (decrease) in accrued expenses		208,376
(116,249)		
Increase (decrease) in income taxes payable		247,117
(392,678)		
<u>Net cash provided by (used in) operating activities</u>		<u>443,844</u>
298,929		
<u>CASH FLOWS FROM INVESTING ACTIVITIES:</u>		
Capital expenditures		(1,012,822)
(1,141,682)		
Decrease in mortgage backed and other investment securities		294,124
6,236		
Decrease in other assets		83,565
12,035		
Payment for purchase of Austin Taylor Communications, Ltd.		(135,131)
Payment for purchase of Automatic Tool and Connector Company, Inc., net of cash acquired		(1,173,577)
<u>Net cash used in investing activities</u>		<u>(1,943,841)</u>
(1,123,411)		
<u>CASH FLOWS FROM FINANCING ACTIVITIES:</u>		
Repayment of notes payable		(36,555)
(47,635)		

Dividends paid	(642,838)
(539,191)	
Proceeds from issuance of common stock	150,700
412,462	
Purchases of Communications Systems, Inc. common stock	
(220,331)	
	<hr/>
Net cash used in financing activities	(528,693)
(394,695)	
	<hr/>
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	(13,566)
(59,692)	
	<hr/>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,042,256)
(1,278,869)	
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	12,198,455
8,829,776	
	<hr/>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$10,156,199
\$7,550,907	
	<hr/>
	<hr/>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:	
Income taxes paid	\$227,883
\$1,193,076	
Interest paid	6,453
13,679	

See notes to consolidated financial statements.

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

NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS

The balance sheet and statement of stockholders' equity as of March 31, 1996, and the statements of income and statements of cash flows for the three month periods ended March 31, 1996 and 1995 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 March 31, 1996 and 1995 have been made.

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

NOTE 2 - CHANGES IN ACCOUNTING PRINCIPLES

Effective January 1, 1996, the Company adopted Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123). SFAS 123 required expanded disclosures of stock-based compensation arrangements with employees and encourages (but does not require) compensation cost to be measured based on the fair value of the equity instrument awarded. Companies are permitted, however, to continue to apply APB Opinion No. 25, which recognizes compensation cost based on the intrinsic value of the equity instrument awarded. The Company will continue to apply APB Opinion No. 25 to its stock-based compensation awards to employees and will disclose the required pro forma effect on net income and earnings per share.

NOTE 3 - INVENTORIES

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

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	March 31 1996	December 31 1995
<S>	<C>	<C>
Finished Goods	\$5,479,160	\$5,475,458
Raw Materials	15,533,960	14,047,505
Total	\$21,013,120	\$19,522,963

NOTE 4 - 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 March 31, 1996 and 1995 income taxes do not bear a normal relationship to income before income taxes, primarily because income from Puerto Rico operations are taxed at rates lower than the U.S. rate.

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

NOTE 5 - 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.

NOTE 6 - ACQUISITION OF AUTOMATIC TOOL AND CONNECTOR CO., INC.

Effective January 4, 1996, the Company acquired Automatic Tool and Connector Co., Inc., a Union, New Jersey based manufacturer of fiber optic connectors, in exchange for \$1,373,000 in cash and 112,676 shares of Communications Systems, Inc. common stock. The acquisition was accounted for as a purchase and the purchase price was allocated to the assets acquired. Excess of cost over net assets acquired was \$2,760,000, which is being amortized over ten years on a straight line basis. Results of Automatic Tool, which were not material to the Company's financial results, were included in Company operations beginning January 4, 1996.

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

Three Months Ended March 31, 1996 Compared to  
Three Months Ended March 31, 1995

Consolidated revenues decreased \$4,347,000 or 18% from the 1995 period. Telephone station apparatus revenue decreased \$2,228,000 or 12%. Apparatus sales to domestic (U.S. and Puerto Rico) customers decreased \$1,483,000 or 11%. The domestic sales decrease was due to lower sales to the Big 8 telephone companies (the seven Regional Bell Operating Companies and GTE) which fell \$1,805,000 or 21%. Reduced shipments to this market segment were attributed to customer inventory overstocks and reduced construction activity caused by the cold winter. Sales to electrical distributors and original equipment manufacturers decreased \$342,000 or 21%. Sales to retailers decreased \$377,000 or 26%. Lower sales to these segments were offset by increased sales to other distributors and by sales of fiber optic connectors by Automatic Tool and Connector Co., which the Company acquired in January, 1996.

Sales of telephone station apparatus to international customers decreased \$745,000 or 17%. Sales by Austin Taylor, the Company's United Kingdom based subsidiary, decreased \$848,000 or 22% due to the phase-out of certain products previously sold to British Telecom. Shipments of new products intended to replace this business were delayed until summer. U.S. export sales increased \$108,000 or 40%. Sales in Canada decreased \$6,000 or 2%.

Contract manufacturing sales decreased \$2,119,000 or 31%. Sales to Thermo-King, which was the segment's principal customer, declined \$2,069,000 or 62%, due to Thermo-King's decision to move more of its manufacturing process to a plant it owns in Puerto Rico. Sales to Thermo-King accounted for 27% of Zercom's sales in the 1996 period compared to 49% of sales in the 1995 period. Sales of multi-function display units used by a major watercraft manufacturer increased \$233,000 or 20%. Sales of electronic fishing products decreased \$162,000 or 35%.

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

Management's Discussion (continued)

Gross margin as a percentage of apparatus sales was 29%, unchanged from the 1995 period. Margin percentages improved in U.S. plants due to reduction in manufacturing overheads, freight charges and payroll overtime premiums. Margins earned on Austin Taylor products declined to 21% from 29% in the 1995 period due to increased raw material costs. Gross margin on contract manufacturing sales increased to 13% compared to 12% in 1995 due to inventory reserves established on certain slow-moving inventory items in the 1995 period.

Selling, general and administrative expenses decreased \$155,000 or 5% from the 1995 period due to decreased customer delivery charges and lower selling expenses.

Consolidated operating income decreased \$651,000 or 21%. Net other income decreased \$150,000 from the 1995 period due to fluctuations in the value of the Company's marketable securities portfolio. The Company's effective income tax rate was 19% compared to 24% in the 1994 period. The Company's tax rate is lower than the full U.S. rate due to tax exemptions and benefits received by the Company's Puerto Rico operations. The Company's tax rate was higher 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 decreased \$476,000, or 19%.

Liquidity and Capital Commitments

At March 31, 1996 the Company had approximately \$10,156,000 in cash compared to \$12,198,000 at December 31, 1995. Working capital was \$36,382,000 compared to \$35,929,000 at December 31, 1995. The Company's current ratio was 4.6 to 1, compared to 4.9 to 1 at year end 1995.

Net cash provided by operating activities was \$444,000 compared to \$299,000 in the first quarter of 1995. The Company used cash in the first quarter to finance increased inventory and accounts receivable levels, which negatively affected cash provided by operations. The Company expects its operating cash flows for the full year to approximate the results of 1995, which produced cash from operations of \$6,983,000. Cash was also utilized during the period to purchase new plant and equipment, pay dividends and acquire Automatic Tool and Connector Co., Inc.

The Company's balance sheet remains strong, with stockholders' equity of \$57,267,000 and no long-term debt. The Company has available a \$2,000,000 bank line of credit. Management believes, based on the Company's current financial position and projected future expenditures, that sufficient funds are available to meet the Company's anticipated needs.

On January 4, 1996, the Company acquired Automatic Tool and Connector Co., Inc. of Union, New Jersey, in exchange for \$3,091,000 in cash and common stock. Automatic Tool and Connector Co. (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 entrance into the market for fiber optic connectors, which is the fastest growing segment in the telecommunications connector market. ATC's sales for its 1995 fiscal year were approximately \$3,200,000.

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

Liquidity (continued)

This acquisition, as well as other acquisitions and dispositions the Company has made over the past several years (including the 1992 acquisition of Austin Taylor Communications, Ltd.), have served to expand the Company's product offerings and customer base in both U.S. and international markets. The Company is seeking to position itself in the marketplace as a growth oriented manufacturer of telecommunications connecting devices. The Company is continuing to search for acquisition candidates which fit the Company's target markets.

PART II. OTHER INFORMATION

Items 1 - 5. Not Applicable

Item 6. Exhibits and Reports on Form 8-K

On January 5, 1996, the Company filed a Form 8-K dated January 4, 1996 reporting the acquisition of Automatic Tool and Connector Co., Inc. under Item 5, "Other Events".

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: May 13, 1996



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