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, 2019**

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: 001-31588

# 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.) |
| 10900 Red Circle Drive, Minnetonka, MN | 55343 |
| (Address of principal executive offices) | (Zip Code) |

(952) 996-1674
Registrant's telephone number, including area code

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 ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ☒ NO ☐

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company (as defined by Rule 12b-2 of the Exchange Act).

Large Accelerated Filer ☐ Accelerated Filer ☐ Non-Accelerated Filer ☐
Smaller Reporting Company ☒ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act. YES ☐ NO ☒

Securities Registered Pursuant to Section 12(b) of the Act

| Title of Each Class | Trading Symbol | Name of each exchange on which registered |
|---|---|---|
| Common Stock, par value , $.05 per share | JCS | Nasdaq |

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

| | |
|---|---|
| Outstanding at August 1, 2019 | 9,324,785 |

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

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**COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(Unaudited)**

**ASSETS**

| | June 30 2019 | December 31 2018 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 13,152,452 | $ 11,056,426 |
| Restricted cash | 625,664 | — |
| Investments | 4,000,974 | — |
| Trade accounts receivable, less allowance for doubtful accounts of $153,000 and $136,000, respectively | 10,907,395 | 13,401,042 |
| Inventories | 13,648,913 | 16,175,616 |
| Prepaid income taxes | 62,147 | 148,036 |
| Other current assets | 1,628,792 | 1,553,972 |
| TOTAL CURRENT ASSETS | 44,026,337 | 42,335,092 |
| | | |
| PROPERTY, PLANT AND EQUIPMENT, net | 9,607,354 | 10,962,239 |
| OTHER ASSETS: | | |
| Deferred income taxes | 19,068 | 19,068 |
| Operating lease right of use asset | 422,935 | — |
| Other assets, net | — | 4,765 |
| TOTAL OTHER ASSETS | 442,003 | 23,833 |
| TOTAL ASSETS | $ 54,075,694 | $ 53,321,164 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 3,522,386 | $ 5,394,981 |
| Accrued compensation and benefits | 2,084,272 | 2,892,199 |
| Operating lease liability | 94,316 | — |
| Other accrued liabilities | 3,015,352 | 3,168,049 |
| Dividends payable | 193,294 | 184,541 |
| TOTAL CURRENT LIABILITIES | 8,909,620 | 11,639,770 |
| LONG TERM LIABILITIES: | | |
| Long-term compensation plans | 78,941 | — |
| Uncertain tax positions | — | 28,267 |
| Operating lease liability | 313,690 | — |
| TOTAL LONG-TERM LIABILITIES | 392,631 | 28,267 |
| COMMITMENTS AND CONTINGENCIES (Footnote 9) | | |
| 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; 9,316,576 and 9,158,438 shares issued and outstanding, respectively | 465,829 | 457,922 |
| Additional paid-in capital | 43,176,179 | 42,680,499 |
| Retained earnings (accumulated deficit) | 1,901,373 | (734,001) |
| Accumulated other comprehensive loss | (769,938) | (751,293) |
| TOTAL STOCKHOLDERS' EQUITY | 44,773,443 | 41,653,127 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 54,075,694 | $ 53,321,164 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

## COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)
## (Unaudited)

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Sales | $ 15,400,076 | $ 15,038,159 | $ 32,123,370 | $ 31,811,844 |
| Cost of sales | 9,692,074 | 11,053,074 | 19,988,403 | 22,648,140 |
| Gross profit | 5,708,002 | 3,985,085 | 12,134,967 | 9,163,704 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 5,972,100 | 6,707,289 | 12,218,430 | 13,860,128 |
| Total operating expenses | 5,972,100 | 6,707,289 | 12,218,430 | 13,860,128 |
| Operating loss | (264,098) | (2,722,204) | (83,463) | (4,696,424) |
| Other income (expenses): | | | | |
| Investment and other income | 76,742 | 89,131 | 121,632 | 193,252 |
| Gain (loss) on sale of assets | 9,660 | (10,480) | 8,725 | 17,051 |
| Gain on sale of FutureLink Fiber business line | 2,966,906 | — | 2,966,906 | — |
| Interest and other expense | (9,594) | (9,482) | (19,038) | (19,188) |
| Other income, net | 3,043,714 | 69,169 | 3,078,225 | 191,115 |
| Income (Loss) from operations before income taxes | 2,779,616 | (2,653,035) | 2,994,762 | (4,505,309) |
| Income tax expense (benefit) | 6,438 | (11,525) | (18,529) | (3,955) |
| Net income (loss) | 2,773,178 | (2,641,510) | 3,013,291 | (4,501,354) |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrealized loss (gain) on available-for-sale securities | 403 | 4,433 | 403 | (1,998) |
| Foreign currency translation adjustment | (47,666) | (104,998) | (19,048) | (70,905) |
| Total other comprehensive loss | (47,263) | (100,565) | (18,645) | (72,903) |
| Comprehensive income (loss) | $ 2,725,915 | $ (2,742,075) | $ 2,994,646 | $ (4,574,257) |
| | | | | |
| Basic net income (loss) per share: | $ 0.30 | $ (0.29) | $ 0.33 | $ (0.50) |
| Diluted net income (loss) per share: | $ 0.30 | $ (0.29) | $ 0.33 | $ (0.50) |
| Weighted Average Basic Shares Outstanding | 9,316,576 | 9,132,855 | 9,246,233 | 9,066,886 |
| Weighted Average Dilutive Shares Outstanding | 9,319,106 | 9,132,855 | 9,246,233 | 9,066,886 |
| Dividends declared per share | $ 0.02 | $ 0.04 | $ 0.04 | $ 0.08 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

**COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
**(Unaudited)**

**For the Six Months Ended June 30, 2019**

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| BALANCE AT DECEMBER 31, 2018 | 9,158,438 | $ 457,922 | $ 42,680,499 | $ (734,001) | $ (751,293) | $ 41,653,127 |
| Net income | — | — | — | 3,013,291 | — | 3,013,291 |
| Issuance of common stock under Employee Stock Purchase Plan | 21,477 | 1,074 | 47,520 | — | — | 48,594 |
| Issuance of common stock to Employee Stock Ownership Plan | 132,826 | 6,641 | 262,995 | — | — | 269,636 |
| Issuance of common stock under Executive Stock Plan | 4,575 | 229 | — | — | — | 229 |
| Share based compensation | — | — | 188,587 | — | — | 188,587 |
| Other share retirements | (740) | (37) | (3,422) | 1,494 | — | (1,965) |
| Shareholder dividends ($0.04 per share) | — | — | — | (379,411) | — | (379,411) |
| Other comprehensive loss | — | — | — | — | (18,645) | (18,645) |
| BALANCE AT JUNE 30, 2019 | 9,316,576 | $ 465,829 | $ 43,176,179 | $ 1,901,373 | $ (769,938) | $ 44,773,443 |

**For the Three Months Ended June 30, 2019**

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| BALANCE AT MARCH 31, 2019 | 9,308,520 | $ 465,426 | $ 43,036,333 | $ (677,819) | $ (722,675) | $ 42,101,265 |
| Net income | — | — | — | 2,773,178 | — | 2,773,178 |
| Issuance of common stock under Employee Stock Purchase Plan | 8,056 | 403 | 20,946 | — | — | 21,349 |
| Share based compensation | — | — | 118,900 | — | — | 118,900 |
| Shareholder dividends ($0.02 per share) | — | — | — | (193,986) | — | (193,986) |
| Other comprehensive loss | — | — | — | — | (47,263) | (47,263) |
| BALANCE AT JUNE 30, 2019 | 9,316,576 | $ 465,829 | $ 43,176,179 | $ 1,901,373 | $ (769,938) | $ 44,773,443 |

**For the Six Months Ended June 30, 2018**

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| BALANCE AT DECEMBER 31, 2017 | 8,973,708 | $ 448,685 | $ 42,006,750 | $ 7,328,671 | $ (613,379) | $ 49,170,727 |
| Net loss | — | — | — | (4,501,354) | — | (4,501,354) |
| Issuance of common stock under Employee Stock Purchase Plan | 13,825 | 691 | 49,758 | — | — | 50,449 |
| Issuance of common stock to Employee Stock Ownership Plan | 119,632 | 5,982 | 419,908 | — | — | 425,890 |
| Issuance of common stock under Executive Stock Plan | 43,501 | 2,175 | — | — | — | 2,175 |
| Share based compensation | — | — | 109,783 | — | — | 109,783 |
| Other share retirements | (8,017) | (401) | (37,387) | 9,325 | — | (28,463) |
| Shareholder dividends ($0.08 per share) | — | — | — | (732,228) | — | (732,228) |
| Other comprehensive loss | — | — | — | — | (72,903) | (72,903) |
| BALANCE AT JUNE 30, 2018 | 9,142,649 | $ 457,132 | $ 42,548,812 | $ 2,104,414 | $ (686,282) | $ 44,424,076 |

**For the Three Months Ended June 30, 2018**

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| | Shares | Amount | | | | |
| BALANCE AT MARCH 31, 2018 | 9,122,986 | $ 456,149 | $ 42,501,770 | $ 5,113,019 | $ (585,717) | $ 47,485,221 |
| Net loss | — | — | — | (2,641,510) | — | (2,641,510) |
| Issuance of common stock under Employee Stock Purchase Plan | 5,870 | 293 | 21,836 | — | — | 22,129 |
| Issuance of common stock under Executive Stock Plan | 13,793 | 690 | — | — | — | 690 |
| Share based compensation | — | — | 25,206 | — | — | 25,206 |
| Shareholder dividends ($0.04 per share) | — | — | — | (367,095) | — | (367,095) |
| Other comprehensive loss | — | — | — | — | (100,565) | (100,565) |
| BALANCE AT JUNE 30, 2018 | 9,142,649 | $ 457,132 | $ 42,548,812 | $ 2,104,414 | $ (686,282) | $ 44,424,076 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

**COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Unaudited)**

| | Six Months Ended June 30 | |
|---|---|---|
| | 2019 | 2018 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | $ 3,013,291 | $ (4,501,354) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 755,101 | 1,172,556 |
| Share based compensation | 188,587 | 109,783 |
| Gain on sale of FutureLink Fiber business line | (2,966,906) | — |
| Gain on sale of assets | (8,725) | (17,051) |
| Changes in assets and liabilities: | | |
| Trade accounts receivable | 2,488,128 | 669,937 |
| Inventories | 1,486,916 | (1,604,564) |
| Prepaid income taxes | 86,709 | 34,012 |
| Other assets, net | (80,145) | (439,897) |
| Accounts payable | (1,907,800) | 788,435 |
| Accrued compensation and benefits | (459,520) | 106,896 |
| Other accrued liabilities | (167,070) | 1,204,309 |
| Income taxes payable | (28,267) | (4,065) |
| Net cash provided by (used in) operating activities | 2,400,299 | (2,481,003) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (259,497) | (612,273) |
| Purchases of investments | (4,000,571) | (3,488,793) |
| Proceeds from the sale of FutureLink Fiber business line | 4,857,214 | — |
| Proceeds from the sale of property, plant and equipment | 59,639 | 39,263 |
| Proceeds from the sale of investments | — | 2,921,913 |
| Net cash provided by (used in) investing activities | 656,785 | (1,139,890) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Cash dividends paid | (370,658) | (761,157) |
| Proceeds from issuance of common stock, net of shares withheld | 46,858 | 24,161 |
| Net cash used in financing activities | (323,800) | (736,996) |
| EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH | (11,594) | (29,470) |
| NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS AND RESTRICTED CASH | 2,721,690 | (4,387,359) |
| CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT BEGINNING OF PERIOD | 11,056,426 | 12,453,663 |
| CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT END OF PERIOD | $ 13,778,116 | $ 8,066,304 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Income taxes refunded | $ (76,151) | $ (33,902) |
| Interest paid | 18,939 | 18,969 |
| Dividends declared not paid | 193,294 | 368,222 |
| Capital expenditures in accounts payable | 39,129 | 21,310 |
| Operating right of use assets obtained in exchange for lease obligations | 449,995 | — |

The accompanying notes are an integral part of the condensed consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Communications Systems, Inc. (herein collectively referred to as “CSI,” “our,” “we” or the “Company”) is a Minnesota corporation organized in 1969 that operates directly and through its subsidiaries located in the United States (U.S.) and the United Kingdom (U.K.). CSI is principally engaged through its Transition Networks, Inc. (“Transition Networks” or “Transition”) subsidiary and business unit in the manufacture and sale of core media conversion products, Ethernet switches, and other connectivity and data transmission products, and through its Suttle, Inc. (“Suttle”) subsidiary and business unit in the manufacture and sale of connectivity infrastructure products for broadband and voice communications. Through its JDL Technologies, Inc. (“JDL Technologies” or “JDL”) business unit, CSI provides technology solutions including virtualization, managed services, wired and wireless network design and implementation, and hybrid cloud infrastructure and deployment. Through its Net2Edge Limited (“Net2Edge”) U.K.-based business unit, the Company develops, manufactures and sells Ethernet-based edge network access products to telecommunications carriers.

The Company classifies its businesses into four segments corresponding to the Transition Networks, Suttle, JDL Technologies, and Net2Edge business units. Non-allocated general and administrative expenses are separately accounted for as “Other” in the Company’s segment reporting. Intersegment revenues are eliminated upon consolidation.

Financial Statement Presentation

The condensed consolidated balance sheets and condensed consolidated statement of changes in stockholders’ equity as of June 30, 2019 and the related condensed consolidated statements of income (loss) and comprehensive income (loss), and the condensed consolidated statements of cash flows for the periods ended June 30, 2019 and 2018 have been prepared by Company management. In the opinion of management, all adjustments (which include only normal recurring adjustments, except where noted) necessary to present fairly the financial position, results of operations, and cash flows at June 30, 2019 and 2018 and for the periods then ended have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted. We recommend these condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company’s December 31, 2018 Annual Report to Shareholders on Form 10-K. The results of operations for the period ended June 30, 2019 are not necessarily indicative of operating results for the entire year.

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 balance sheet date, and the reported amounts of revenues and expenses during the reporting period. The estimates and assumptions used in the accompanying condensed consolidated financial statements are based upon management’s evaluation of the relevant facts and circumstances as of the time of the financial statements. Actual results could differ from those estimates.

Except to the extent updated or described below, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, appropriately represent, in all material respects, the current status of accounting policies, and are incorporated herein by reference.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of tax, are as follows:

| | Foreign Currency Translation | Unrealized gain on securities | Accumulated Other Comprehensive Loss |
|---|---|---|---|
| **December 31, 2018** | $ (764,000) | $ 13,000 | $ (751,000) |
| Net current period change | (20,000) | 1,000 | (19,000) |
| **June 30, 2019** | $ (784,000) | $ 14,000 | $ (770,000) |

NOTE 2 – REVENUE RECOGNITION

*Transition Networks & Suttle, Inc.*

The Company has determined that the revenue recognition for its Suttle and Transition Networks divisions occurs upon delivery of the Company's connectivity infrastructure and data transmission products. To determine when revenue should be recognized, it is important to determine when the transfer of control has occurred. The Company has determined that control transfers for these products upon shipment or delivery to the customer, in accordance with the agreed upon shipping terms. As such, the timing of revenue recognition occurs at a specific point in time.

*JDL Technologies, Inc.*

The Company has determined that the following performance obligations identified in its JDL Technologies, Inc. division are transferred over time: managed services and professional services (time and materials ("T&M") and fixed price). JDL's managed services performance obligation is a bundled solution, a series of distinct services that are substantially the same and that have the same pattern of transfer to the customer and are recognized evenly over the term of the contract. T&M professional services arrangements are measured over time with an input method based on hours expended towards satisfying this performance obligation. Fixed price professional service arrangements under a relatively longer-term service will also be measured over time with an input method based on hours expended.

The Company has also identified the following performance obligations within its JDL Technologies division that are recognized at a point in time which include resale of third-party hardware and software, installation, arranging for another party to transfer services to the customer, and certain professional services. The resale of third-party hardware and software is recognized at a point in time, when the goods are shipped or delivered to the customer's location, in accordance with the shipping terms. Installation services are recognized at a point in time when the services are completed. The service the Company provides to arrange for another party to transfer services to the customer is satisfied at a point in time as the Company has transferred control upon the service first being made available to the customer by the third party vendor. The Company reports revenue from these third party services on a net basis in its financial statements. Depending on the nature of the service, certain professional services transfer control at a point in time. The Company evaluates these circumstances on a case by case basis to determine if revenue should be recognized over time or at a point in time.

*Net2Edge Limited*

The Company's Net2Edge division manufactures and markets Ethernet based edge network access devices. The Company principally sells these products through approved partners and integrators outside the United States. The Company has determined that the performance obligation in the Net2Edge division is recognized at a point in time, upon the delivery of its connectivity infrastructure and data transmission products.

*Disaggregation of revenue*

Revenues are recognized when control of the promised goods or services is transferred to our customers, in an amount that best reflects the consideration we expect to receive in exchange for those goods or services. In accordance with ASC 606-10-50-5, the following tables present how we disaggregate our revenues, which is different for each segment.

For Transition Networks, we analyze revenue by region and product group, which is as follows for the three and six months ended June 30, 2019 and 2018:

| | Transition Networks Sales by Region | | | |
|---|---|---|---|---|
| | Three Months Ended June 30 | | Six Months Ended June 30 | |
| | 2019 | 2018 | 2019 | 2018 |
| North America | $ 8,052,000 | $ 6,450,000 | $ 14,963,000 | $ 14,092,000 |
| Rest of World | 672,000 | 864,000 | 1,396,000 | 1,840,000 |
| Europe, Middle East, Africa ("EMEA") | 451,000 | 520,000 | 1,706,000 | 1,056,000 |
| | $ 9,175,000 | $ 7,834,000 | $ 18,065,000 | $ 16,988,000 |

| | Transition Networks Sales by Product Group | | | |
|---|---|---|---|---|
| | Three Months Ended June 30 | | Six Months Ended June 30 | |
| | 2019 | 2018 | 2019 | 2018 |
| Media converters | $ 4,683,000 | $ 4,492,000 | $ 10,061,000 | $ 9,677,000 |
| Ethernet switches and adapters | 2,831,000 | 1,827,000 | 4,831,000 | 4,086,000 |
| Other products | 1,661,000 | 1,515,000 | 3,173,000 | 3,225,000 |
| | $ 9,175,000 | $ 7,834,000 | $ 18,065,000 | $ 16,988,000 |

For Suttle, we analyze revenues by product and customer group, which is as follows for the three and six months ended June 30, 2019 and 2018:

| | Suttle Sales by Product Group | | | |
|---|---|---|---|---|
| | Three Months Ended June 30 | | Six Months Ended June 30 | |
| | 2019 | 2018 | 2019 | 2018 |
| Structured cabling and connecting system products | $ 3,766,000 | $ 5,169,000 | $ 8,843,000 | $ 11,742,000 |
| DSL and other products | 981,000 | 704,000 | 1,425,000 | 1,104,000 |
| | $ 4,747,000 | $ 5,873,000 | $ 10,268,000 | $ 12,846,000 |

| | Suttle Sales by Customer Group | | | |
|---|---|---|---|---|
| | Three Months Ended June 30 | | Six Months Ended June 30 | |
| | 2019 | 2018 | 2019 | 2018 |
| Communication service providers | $ 3,367,000 | $ 4,500,000 | $ 7,958,000 | $ 10,447,000 |
| International | 109,000 | 766,000 | 508,000 | 1,346,000 |
| Distributors | 568,000 | 607,000 | 1,099,000 | 1,053,000 |
| Other | 703,000 | — | 703,000 | — |
| | $ 4,747,000 | $ 5,873,000 | $ 10,268,000 | $ 12,846,000 |

For JDL, we analyze revenue by customer group, which is as follows for the three and six months ended June 30, 2019 and 2018:

| | JDL Revenue by Customer Group | | | |
|---|---|---|---|---|
| | Three Months Ended June 30 | | Six Months Ended June 30 | |
| | 2019 | 2018 | 2019 | 2018 |
| Education | $ 295,000 | $ 280,000 | $ 1,768,000 | $ 388,000 |
| Healthcare and commercial clients | 656,000 | 633,000 | 1,392,000 | 1,234,000 |
| | $ 951,000 | $ 913,000 | $ 3,160,000 | $ 1,622,000 |

The Company does not currently analyze revenue for Net2Edge on a disaggregated basis. Revenues from Net2Edge were $796,000 and $681,000 for the three months ended June 30, 2019 and 2018, respectively. Revenues were $1,244,000 and $846,000 for the six months ended June 30, 2019 and 2018, respectively.

NOTE 3 – LEASES

In February 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-02,*Leases* (ASC Topic 842), which is intended to improve financial reporting of leasing transactions by requiring organizations that lease assets to recognize assets and liabilities for the rights and obligations created by leases that extend more than twelve months on the balance sheet. This accounting update also requires additional disclosures surrounding the amount, timing, and uncertainty of cash flows arising from leases. This standard is effective for financial statements issued for annual and interim periods beginning after December 15, 2018 for public business entities.

The Company adopted this standard with a cumulative-effect adjustment as of January 1, 2019, the beginning of the period of adoption. The Company has elected the package of practical expedients permitted in ASC Topic 842. Adoption of the new standard resulted in the recording of right of use ("ROU") assets and lease liabilities of approximately $280,000 and $259,000, respectively as of January 1, 2019. ROU assets represent our right to use an underlying asset for the lease term, while lease liabilities represent our obligation to make lease payments arising from the lease. Lease ROU assets and liabilities are recognized at the commencement date of a lease based on the present value of lease payments over the lease term. Because the rate implicit in each individual lease is not readily determinable, the Company uses its incremental borrowing rate to determine the present value of the lease payments. Adoption of the standard did not materially impact the Company's condensed consolidated balance sheets, consolidated statement of income (loss) and comprehensive income (loss) or condensed consolidated statements of cash flows.

The Company has entered into operating leases for two office locations, including one in February 2019. These leases have remaining lease terms of 5 to 8 years. One of the leases includes two options to extend the lease for 5 years each, and the other lease includes an option to terminate the lease in 2022. One of the leases includes a 3% rent adjustment on each anniversary of the lease. As of June 30, 2019, total ROU assets and operating lease liabilities were $423,000 and $408,000, respectively. All operating lease expense is recognized on a straight-line basis over the lease term. In the three and six months ended June 30, 2019, the Company recognized $32,000 and $61,000 in lease expense, respectively.

Information related to the Company's ROU assets and related lease liabilities were as follows:

| | Three Months Ended June 30, 2019 | Six Months Ended June 30, 2019 |
|---|---|---|
| Cash paid for operating leases | $ 33,000 | $ 50,000 |
| Right-of-use assets obtained in exchange for new operating lease obligations(1) | — | 450,000 |

| | As of June 30, 2019 |
|---|---|
| Weighted-average remaining lease term | 3.8 years |
| Weighted-average discount rate | 4.5% |

(1) Includes $262,000 for operating leases existing on January 1, 2019 and $188,000 for operating leases that commenced in the first quarter of 2019.

Maturities of lease liabilities as of June 30, 2019 were as follows:

| | |
|---|---|
| Q3 - Q4 2019 | $ 63,000 |
| 2020 | 124,000 |
| 2021 | 129,000 |
| 2022 | 88,000 |
| 2023 | 47,000 |
| Thereafter | 4,000 |
| Total lease payments | 455,000 |
| Less imputed interest | (47,000) |
| Total operating lease liabilities | $ 408,000 |

Future minimum lease commitments under operating leases based on accounting standards applicable as of December 31, 2018 were as follows:

| | | | |
|---|---|---|---|
| Year Ending December 31: | | | |
| | 2019 | $ | 106,000 |
| | 2020 | | 86,000 |
| | 2021 | | 86,000 |
| | 2022 | | 50,000 |
| | | $ | 328,000 |

As of June 30, 2019, the Company does not have any additional future operating lease obligations that have not yet commenced.

NOTE 4 – CASH EQUIVALENTS AND INVESTMENTS

The following tables show the Company's cash equivalents and available –for-sale securities' amortized cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or short and long term investments as of June 30, 2019 and December 31, 2018:

**June 30, 2019**

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Cash Equivalents | Short-Term Investments | Long-Term Investments |
|---|---|---|---|---|---|---|---|
| Cash equivalents: | | | | | | | |
| Money Market funds | $ 9,540,000 | $ — | $ — | $ 9,540,000 | $ 9,540,000 | $ — | $ — |
| Subtotal | 9,540,000 | — | — | 9,540,000 | 9,540,000 | — | — |
| Investments: | | | | | | | |
| Commercial Paper | 1,992,000 | — | — | 1,992,000 | — | 1,992,000 | — |
| Corporate Notes/Bonds | 2,009,000 | — | — | 2,009,000 | — | 2,009,000 | — |
| Subtotal | 4,001,000 | — | — | 4,001,000 | — | 4,001,000 | — |
| Total | $ 13,541,000 | $ — | $ — | $ 13,541,000 | $ 9,540,000 | $ 4,001,000 | $ — |

| | December 31, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Cash Equivalents | Short-Term Investments | Long-Term Investments |
| Cash equivalents: | | | | | | | |
| Money Market funds | $ 8,428,000 | $ — | $ — | $ 8,428,000 | $ 8,428,000 | $ — | $ — |
| Total | $ 8,428,000 | $ — | $ — | $ 8,428,000 | $ 8,428,000 | $ — | $ — |

The Company tests for other than temporary losses on a quarterly basis. The Company intends to hold the investments until it can recover the full principal amount and has the ability to do so based on other sources of liquidity. The Company expects such recoveries to occur prior to the contractual maturities. The Company did not have any unrealized losses as of June 30, 2019.

The following table summarizes the estimated fair value of our investments, designated as available-for-sale and classified by the contractual maturity date of the securities as of June 30, 2019:

| | Amortized Cost | Estimated Market Value |
|---|---|---|
| Due within one year | $ 4,001,000 | $ 4,001,000 |

The Company did not recognize any gross realized gains or losses during either of the six-month periods ending June 30, 2019 and 2018, respectively. If the Company had realized gains or losses, they would be included within investment and other income in the accompanying condensed consolidated statement of income (loss) and comprehensive income (loss).

NOTE 5 - STOCK-BASED COMPENSATION

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan ("ESPP"), employees are able to acquire shares of common stock at 85% of the price at the end of each current quarterly plan term. The most recent term ended June 30, 2019. The ESPP is considered compensatory under current Internal Revenue Service rules. At June 30, 2019, after giving effect to the shares issued as of that date, 102,114 shares remain available for future issuance under the ESPP.

2011 Executive Incentive Compensation Plan

On March 28, 2011 the Board adopted and on May 19, 2011 the Company's shareholders approved the Company's 2011 Executive Incentive Compensation Plan ("2011 Incentive Plan"). The 2011 Incentive Plan authorizes incentive awards to officers, key employees and non-employee directors in the form of options (incentive and non-qualified), stock appreciation rights, restricted stock, restricted stock units, performance stock units ("deferred stock"), performance cash units, and other awards in stock, cash, or a combination of stock and cash. The 2011 Incentive Plan, as amended, allows the issuance of up to 2,500,000 shares of common stock.

During 2019, stock options covering 100,769 shares have been awarded to key executive employees and directors. These options expire seven years from the date of award and generally vest 25% each year beginning one year after the date of award. The Company also granted deferred stock awards of 157,907 shares to key employees during the first quarter of 2019 under the Company's long-term incentive plan. These awards vest over three years with the first vesting date being March 28, 2020.

At June 30, 2019, 213,130 shares have been issued under the 2011 Incentive Plan, 1,681,614 shares are subject to currently outstanding options, deferred stock awards, and unvested restricted stock units, and 605,256 shares are eligible for grant under future awards.

Stock Option Plan for Directors

Shares of common stock are reserved for issuance to non-employee directors under options granted by the Company prior to 2011 under its Stock Option Plan for Non-Employee Directors (the "Director Plan"). Under the Director Plan nonqualified stock options to acquire shares of common stock were automatically granted to each non-employee director concurrent with annual meetings of shareholders in 2010 and earlier years, with the exercise price of options granted being the fair market value of the common stock on the date of the respective shareholder meetings. Options granted under the Director Plan expire 10 years from date of grant. No options have been granted under the Director Plan since 2011 when the Company amended the Director Plan to prohibit future option grants. As of June 30, 2019, there were 18,000 shares subject to outstanding options under the Director Plan.

Changes in Stock Options Outstanding

The following table summarizes changes in the number of outstanding stock options under the 2011 Incentive Plan and the Director Plan over the period December 31, 2018 to June 30, 2019:

| | Options | | Weighted average exercise price per share | Weighted average remaining contractual term in years |
|---|---|---|---|---|
| Outstanding – December 31, 2018 | 1,380,492 | $ | 7.56 | 4.18 |
| Awarded | 100,769 | | 2.69 | |
| Exercised | — | | — | |
| Forfeited | (147,127) | | 10.84 | |
| Outstanding – June 30, 2019 | 1,334,134 | | 6.83 | 4.15 |
| | | | | |
| Exercisable at June 30, 2019 | 982,665 | $ | 7.94 | 3.60 |
| Expected to vest June 30, 2019 | 1,334,134 | | 6.83 | 4.15 |

The aggregate intrinsic value of all options (the amount by which the market price of the stock on the last day of the period exceeded the market price of the stock on the date of grant) outstanding at June 30, 2019 was $60,000. The intrinsic value of all options exercised during the six months ended June 30, 2019 was $0. Net cash proceeds from the exercise of all stock options were $0 in each of the six-month periods ended June 30, 2019 and 2018.

Changes in Deferred Stock Outstanding

The following table summarizes the changes in the number of deferred stock shares under the 2011 Incentive Plan over the period December 31, 2018 to June 30, 2019:

| | Shares | | Weighted Average Grant Date Fair Value |
|---|---|---|---|
| Outstanding – December 31, 2018 | 270,066 | $ | 4.48 |
| Granted | 157,907 | | 2.64 |
| Vested | (4,575) | | 4.56 |
| Forfeited | (57,918) | | 4.32 |
| Outstanding – June 30, 2019 | 365,480 | | 3.33 |

Compensation Expense

Share-based compensation expense recognized for the six months ended June 30, 2019 was $189,000 before income taxes and $149,000 after income taxes. Share-based compensation expense recognized for the six months ended June 30, 2018 was $110,000 before income taxes and $87,000 after income taxes. Unrecognized compensation expense for the Company's plans was $527,000 at June 30, 2019 and is expected to be recognized over a weighted-average period of 2.5 years. Share-based compensation expense is recorded as a part of selling, general and administrative expenses.

NOTE 6 - INVENTORIES

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

| | | June 30 2019 | | December 31 2018 |
|---|---|---|---|---|
| Finished goods | $ | 8,720,000 | $ | 9,608,000 |
| Raw and processed materials | | 4,929,000 | | 6,568,000 |
| | $ | 13,649,000 | $ | 16,176,000 |

NOTE 7 –INTANGIBLE ASSETS

The Company's identifiable intangible assets with finite lives, included in other assets, net on the condensed consolidated balance sheets, are being amortized over their estimated useful lives and were as follows:

| | June 30, 2019 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Gross Carrying Amount | | Accumulated Amortization | | Impairment loss | | Foreign Currency Translation | | Net | |
| Trademarks | $ | 98,000 | $ | (78,000) | $ | — | $ | (20,000) | $ | — |
| Customer relationships | | 491,000 | | (230,000) | | (154,000) | | (107,000) | | — |
| Technology | | 229,000 | | (189,000) | | — | | (40,000) | | — |
| | $ | 818,000 | $ | (497,000) | $ | (154,000) | $ | (167,000) | $ | — |

| | December 31, 2018 | | | | |
|---|---|---|---|---|---|
| | **Gross Carrying Amount** | **Accumulated Amortization** | **Impairment loss** | **Foreign Currency Translation** | **Net** |
| Trademarks | $ 98,000 | $ (74,000) | $ — | $ (19,000) | $ 5,000 |
| Customer relationships | 491,000 | (230,000) | (154,000) | (107,000) | — |
| Technology | 229,000 | (178,000) | — | (51,000) | — |
| | $ 818,000 | $ (482,000) | $ (154,000) | $ (177,000) | $ 5,000 |

Amortization expense on these identifiable intangible assets was $5,000 and $6,000 for the six months ended June 30, 2019 and 2018, respectively. The amortization expense is included in selling, general and administrative expenses.

NOTE 8 – WARRANTY

We provide reserves for the estimated cost of product warranties at the time revenue is recognized. We estimate the costs of our warranty obligations based on our warranty policy or applicable contractual warranty, historical experience of known product failure rates, and use of materials and service delivery costs incurred in correcting product failures. Management reviews the estimated warranty liability on a quarterly basis to determine its adequacy. The actual warranty expense could differ from the estimates made by the Company based on product performance. The warranty liability is included in other accrued liabilities on the condensed consolidated balance sheet.

The following table presents the changes in the Company's warranty liability for the six-month periods ended June 30, 2019 and 2018, respectively, the majority of which relates to a five-year obligation to provide for potential future liabilities for network equipment sales.

| | 2019 | 2018 |
|---|---|---|
| Beginning balance | $ 594,000 | $ 603,000 |
| Amounts charged (credited) to expense | (21,000) | 88,000 |
| Actual warranty costs paid | (19,000) | (57,000) |
| Ending balance | $ 554,000 | $ 634,000 |

NOTE 9 – CONTINGENCIES

In the ordinary course of business, the Company is exposed to legal actions and claims and incurs costs to defend against these actions and claims. Company management is not aware of any outstanding or pending legal actions or claims that could materially affect the Company's financial position or results of operations.

NOTE 10 – DEBT

Line of Credit

The Company has a $15,000,000 line of credit from Wells Fargo Bank, N.A.  The Company had no outstanding borrowings against the line of credit at June 30, 2019 or December 31, 2018. Due to the revolving nature of loans under our credit facility, additional borrowings and periodic repayments and re-borrowings may be made until the maturity date. The total amount available for borrowings under our credit facility at June 30, 2019 was $7,404,000, based on the borrowing base calculation. Interest on borrowings on the credit line is at LIBOR plus 2.0% (4.4% at June 30, 2019). The credit agreement expires August 12, 2021 and is secured by assets of the Company.  Our credit agreement contains financial covenants including a minimum liquidity balance of $10,000,000. Liquidity is calculated as the sum of unrestricted cash, marketable securities and the availability on the line of credit. The Company was in compliance with its financial covenants at June 30, 2019.

NOTE 11 – INCOME TAXES

In the preparation of the Company's consolidated financial statements, management calculates income taxes based upon the estimated effective rate applicable to operating results for the full fiscal year. This includes estimating the current tax liability as well as assessing differences resulting from different treatment of items for tax and book accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet. Management analyzes these assets and liabilities regularly and assesses the likelihood that deferred tax assets will be recovered from future taxable income.

At June 30, 2019 there was $98,000 of net uncertain tax benefit positions that would reduce the effective income tax rate if recognized. The Company records interest and penalties related to income taxes as income tax expense in the condensed consolidated statements of income (loss) and comprehensive income (loss).

The Company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. The tax years 2015-2018 remain open to examination by the Internal Revenue Service and the years 2014-2018 remain open to examination by various state tax departments. The tax years from 2015-2018 remain open in Costa Rica.

The Company's effective income tax rate was (0.6%) for the first six months of 2019. The effective tax rate differs from the federal tax rate of 21% due to state income taxes, foreign tax rate differences, foreign losses not deductible for U.S. income tax purposes, the effect of uncertain income tax positions, stock compensation shortfalls, provision true-ups, and changes in valuation allowances related to deferred tax assets. The foreign operating losses may ultimately be deductible in the countries in which they occurred; however, the Company has not recorded a deferred tax asset for these losses due to uncertainty regarding the eventual realization of the benefit. The effect of the foreign operations was an overall rate decrease of approximately 8.0% for the six months ended June 30, 2019. There were no additional uncertain tax positions identified in the first six months of 2019. The Company's effective income tax rate for the six months ended June 30, 2018 was 0.1%, and differed from the federal tax rate due to state income taxes, foreign tax rate differences, foreign losses not deductible for U.S. income tax purposes, provisions for interest charges for uncertain income tax positions, stock compensation shortfalls and changes in valuation allowances related to deferred tax assets.

NOTE 12 – SEGMENT INFORMATION

Effective January 1, 2019, the Company realigned the financial reporting for its business units. As a result of this realignment, certain corporate general and administrative expenses that were previously included within the business unit level as fully allocated costs are now categorized as "Other". The Company classifies its businesses into the four segments as follows:

- Transition Networks manufactures media converters, NIDs, NICs, Ethernet switches and other connectivity products that offer customers the ability to affordably integrate the benefits of fiber optics into any data network;

- Suttle manufactures and markets connectivity infrastructure products for broadband and voice communications;
- JDL Technologies provides technology solutions that address prevalent IT challenges, including virtualization and cloud solutions, managed services, wired and wireless network design and implementation, and converged infrastructure configuration and deployment; and
- Net2Edge develops, manufactures and sells edge network access products to telecommunications carriers.

Management has chosen to organize the Company and disclose reportable segments based on our products and services. Intersegment revenues are eliminated upon consolidation. In order to conform to the 2019 presentation, the Company has reclassified the 2018 corporate expenses previously allocated to reportable segments to the "Other" section.

Information concerning the Company's continuing operations in the various segments for the three and six-month periods ended June 30, 2019 and 2018 are as follows:

| | Transition Networks | Suttle | JDL Technologies | Net2Edge | Other | Intersegment Eliminations | Total |
|---|---|---|---|---|---|---|---|
| Three Months Ended June 30, 2019 | | | | | | | |
| Sales | $ 9,175,000 | $ 4,747,000 | $ 951,000 | $ 796,000 | $ — | $ (269,000) | $ 15,400,000 |
| Cost of sales | 5,232,000 | 3,280,000 | 700,000 | 543,000 | — | (63,000) | 9,692,000 |
| Gross profit | 3,943,000 | 1,467,000 | 251,000 | 253,000 | — | (206,000) | 5,708,000 |
| Selling, general and administrative expenses | 3,575,000 | 938,000 | 331,000 | 760,000 | 574,000 | (206,000) | 5,972,000 |
| Operating income (loss) | 368,000 | 529,000 | (80,000) | (507,000) | (574,000) | — | (264,000) |
| Other income (expense) | (1,000) | 2,980,000 | — | 3,000 | 62,000 | — | 3,044,000 |
| Income (loss) before income tax | $ 367,000 | $ 3,509,000 | $ (80,000) | $ (504,000) | $ (512,000) | $ — | $ 2,780,000 |
| Depreciation and amortization | $ 71,000 | $ 220,000 | $ 26,000 | $ 18,000 | $ — | $ — | $ 335,000 |
| Capital expenditures | $ 4,000 | $ — | $ — | $ 1,000 | $ 28,000 | $ — | $ 33,000 |
| Assets | $ 16,397,000 | $ 9,747,000 | $ 1,658,000 | $ 3,024,000 | $ 23,276,000 | $ (27,000) | $ 54,075,000 |

| | Transition Networks | Suttle | JDL Technologies | Net2Edge | Other | Intersegment Eliminations | Total |
|---|---|---|---|---|---|---|---|
| Three Months Ended June 30, 2018 | | | | | | | |
| Sales | $ 7,834,000 | $ 5,873,000 | $ 913,000 | $ 681,000 | $ — | $ (263,000) | $ 15,038,000 |
| Cost of sales | 4,327,000 | 5,414,000 | 841,000 | 501,000 | — | (30,000) | 11,053,000 |
| Gross profit | 3,507,000 | 459,000 | 72,000 | 180,000 | — | (233,000) | 3,985,000 |
| Selling, general and administrative expenses | 3,266,000 | 1,903,000 | 422,000 | 820,000 | 529,000 | (233,000) | 6,707,000 |
| Operating (loss) income | 241,000 | (1,444,000) | (350,000) | (640,000) | (529,000) | — | (2,722,000) |
| Other income (expense) | 6,000 | (4,000) | 3,000 | 20,000 | 44,000 | — | 69,000 |
| Income (loss) before income tax | $ 247,000 | $ (1,448,000) | $ (347,000) | $ (620,000) | $ (485,000) | $ — | $ (2,653,000) |
| Depreciation and amortization | $ 100,000 | $ 386,000 | $ 41,000 | $ 14,000 | $ — | $ — | $ 541,000 |
| Capital expenditures | $ 18,000 | $ 232,000 | $ — | $ 98,000 | $ — | $ — | $ 348,000 |
| Assets | $ 15,058,000 | $ 15,748,000 | $ 912,000 | $ 2,468,000 | $ 20,780,000 | $ (27,000) | $ 54,939,000 |

| | Transition Networks | Suttle | JDL Technologies | Net2Edge | Other | Intersegment Eliminations | Total |
|---|---|---|---|---|---|---|---|
| Six Months Ended June 30, 2019 | | | | | | | |
| Sales | $ 18,065,000 | $ 10,268,000 | $ 3,160,000 | $ 1,244,000 | $ — | $ (614,000) | $ 32,123,000 |
| Cost of sales | 10,368,000 | 7,000,000 | 2,040,000 | 771,000 | — | (191,000) | 19,988,000 |
| Gross profit | 7,697,000 | 3,268,000 | 1,120,000 | 473,000 | — | (423,000) | 12,135,000 |
| Selling, general and administrative expenses | 7,270,000 | 1,996,000 | 707,000 | 1,508,000 | 1,160,000 | (423,000) | 12,218,000 |
| Operating (loss) income | 427,000 | 1,272,000 | 413,000 | (1,035,000) | (1,160,000) | — | (83,000) |
| Other income (expense) | (1,000) | 2,989,000 | (10,000) | 2,000 | 98,000 | — | 3,078,000 |
| Income (loss) before income tax | $ 426,000 | $ 4,261,000 | $ 403,000 | $ (1,033,000) | $ (1,062,000) | $ — | $ 2,995,000 |
| | | | | | | | |
| Depreciation and amortization | $ 150,000 | $ 513,000 | $ 54,000 | $ 38,000 | $ — | $ — | $ 755,000 |
| | | | | | | | |
| Capital expenditures | $ 4,000 | $ 16,000 | $ 36,000 | $ 8,000 | $ 196,000 | $ — | $ 260,000 |

| | Transition Networks | Suttle | JDL Technologies | Net2Edge | Other | Intersegment Eliminations | Total |
|---|---|---|---|---|---|---|---|
| Six Months Ended June 30, 2018 | | | | | | | |
| Sales | $ 16,988,000 | $ 12,846,000 | $ 1,622,000 | $ 846,000 | $ — | $ (490,000) | $ 31,812,000 |
| Cost of sales | 9,554,000 | 11,012,000 | 1,568,000 | 563,000 | — | (49,000) | 22,648,000 |
| Gross profit | 7,434,000 | 1,834,000 | 54,000 | 283,000 | — | (441,000) | 9,164,000 |
| Selling, general and administrative expenses | 6,731,000 | 3,877,000 | 845,000 | 1,724,000 | 1,124,000 | (441,000) | 13,860,000 |
| Operating (loss) income | 703,000 | (2,043,000) | (791,000) | (1,441,000) | (1,124,000) | — | (4,696,000) |
| Other income | 4,000 | 20,000 | 3,000 | 12,000 | 152,000 | — | 191,000 |
| Income (loss) before income tax | $ 707,000 | $ (2,023,000) | $ (788,000) | $ (1,429,000) | $ (972,000) | $ — | $ (4,505,000) |
| | | | | | | | |
| Depreciation and amortization | $ 241,000 | $ 799,000 | $ 105,000 | $ 28,000 | $ — | $ — | $ 1,173,000 |
| | | | | | | | |
| Capital expenditures | $ 38,000 | $ 459,000 | $ — | $ 115,000 | $ — | $ — | $ 612,000 |

NOTE 13 – NET INCOME (LOSS) PER SHARE

Basic net income (loss) per common share is based on the weighted average number of common shares outstanding during each period and year. Diluted net income per common share takes into effect the dilutive effect of potential common shares outstanding. The Company's only potential common shares outstanding are stock options and shares associated with the long-term incentive compensation plans, which resulted in a dilutive effect of 2,530 and 0 for the three and six-month periods ended June 30, 2019, respectively. Due to the net losses in the first three and six months of 2018, there was no dilutive impact from stock options or unvested shares. The Company calculates the dilutive effect of outstanding options using the treasury stock method. Options totaling 1,173,365 and 1,223,365 were excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2019 because the exercise price was greater than the average market price of common stock during the period and deferred stock awards totaling 207,573 shares would not have been included for the three and six months ended June 30, 2019 because of unmet performance conditions. Options totaling 1,150,107 and 1,178,607 were excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2018 because the exercise price was greater than the average market price of common stock during the period and deferred stock awards totaling 309,819 shares would not have been included for the three and six months ended June 30, 2018 because of unmet performance conditions.

NOTE 14 – FAIR VALUE MEASUREMENTS

The accounting guidance establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 – Observable inputs that reflect unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access at the measurement date.

Level 2 – Observable inputs such as quoted prices for similar instruments and quoted prices in markets that are not active, and inputs that are directly observable or can be corroborated by observable market data. The types of assets and liabilities included in Level 2 are typically either comparable to actively traded securities or contracts, such as treasury securities with pricing interpolated from recent trades of similar securities, or priced with models using highly observable inputs, such as commodity options priced using observable forward prices and volatilities.

Level 3 – Significant inputs to pricing that have little or no observability as of the reporting date. The types of assets and liabilities included in Level 3 are those with inputs requiring significant management judgment or estimation, such as the complex and subjective models and forecasts used to determine the fair value of financial instruments.

Financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2019 and December 31, 2018, are summarized below:

| | June 30, 2019 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total Fair Value** |
| Cash equivalents: | | | | |
| Money Market Funds | $ 9,540,000 | $ — | $ — | $ 9,540,000 |
| Subtotal | 9,540,000 | — | — | 9,540,000 |
| Short-term investments: | | | | |
| Commercial Paper | — | 1,992,000 | — | 1,992,000 |
| Corporate Notes/Bonds | — | 2,009,000 | — | 2,009,000 |
| Subtotal | — | 4,001,000 | — | 4,001,000 |
| Total | $ 9,540,000 | $ 4,001,000 | $ — | $ 13,541,000 |

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Cash equivalents: | | | | |
| Money Market Funds | $ 8,428,000 | $ — | $ — | $ 8,428,000 |
| Total | $ 8,428,000 | $ — | $ — | $ 8,428,000 |

We record transfers between levels of the fair value hierarchy, if necessary, at the end of the reporting period. There were no transfers between levels during the six months ended June 30, 2019.

NOTE 15 – GENERAL COMMITMENTS

On August 2, 2018, the Company entered into a purchase agreement with Launch Properties, LLC for the sale of the Company's building located at 10900 Red Circle Drive, Minnetonka, MN for $10,000,000. The building currently includes the Company's corporate administrative offices, as well as some operations for Transition Networks, Suttle and JDL Technologies. The closing of the transaction is subject to several closing conditions, including the buyer's ability to complete due diligence within 180 days and the buyer's ability to obtain regulatory approval for its intended use of the property. The due diligence period lapsed on January 29, 2019 and the buyer met certain required obligations. One of the conditions of the agreement included non-refundable deposits into an escrow account. As of June 30, 2019, the balance was $125,000 and is included within restricted cash within the condensed consolidated balance sheet. If the sale proceeds, the Company currently expects the transaction to close in the second half of 2020.

NOTE 16 – DISPOSITION OF ASSETS

On April 5, 2019, the Company sold its Suttle FutureLink™ Fiber business line, including inventory, equipment, and customer relationships, to PPC Broadband Inc. ("PPC"). The transaction was structured as an Asset Purchase Agreement with a simultaneous signing and closing. The sale price was $5,000,000 cash, of which $500,000 was deferred into an escrow account until certain criteria are met and is recorded as restricted cash within the condensed consolidated balance sheet. The Company recognized a gain on the sale of inventory and capital equipment totaling $2,967,000. Concurrent with the closing of the transaction, Suttle and PPC entered into a Transition Services Agreement under which Suttle will continue to manufacture products related to the FutureLink™ Fiber business line until September 30, 2019, to ensure seamless supply to the customer base.

NOTE 17 – RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842),which amends existing guidance and requires an entity to recognize both assets and liabilities arising from financing and operating leases, along with additional qualitative and quantitative disclosures. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within that reporting period, and early adoption is permitted. The Company adopted the accounting standard effective January 1, 2019. Please see Note 3 for the required disclosures related to the impact of adopting this standard.

In June 2016, FASB issued ASU 2016-13, “Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments.” The amendments in this update replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses. This ASU is intended to provide financial statement users with more decision-useful information about the expected credit losses and is effective for annual periods and interim periods for those annual periods beginning after December 15, 2019, which for us is the first quarter ending March 31, 2020. Entities may early adopt beginning after December 15, 2018. We are currently evaluating the impact of the adoption of ASU 2016-13 on our consolidated financial statements.

NOTE 18 – SUBSEQUENT EVENTS

The Company has evaluated subsequent events through the date of this filing. We do not believe there are any material subsequent events other than those disclosed in the footnotes to these financial statements that require further disclosure.

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

Overview

Communications Systems, Inc. provides physical connectivity infrastructure and services for global deployments of broadband networks through the following business units:

- Transition Networks manufactures media converters, NIDs, NICs, Ethernet switches and other connectivity products that offer the ability to affordably integrate the benefits of fiber optics into any data network;
- Suttle manufactures and markets connectivity infrastructure products for broadband and voice communications;
- JDL Technologies provides technology solutions that address prevalent IT challenges, including virtualization and cloud solutions, managed services, wired and wireless network design and implementation, and converged infrastructure configuration and deployment; and
- Net2Edge develops, manufactures and sells edge network access products to telecommunications carriers.

**Second Quarter 2019 Summary**

- Consolidated sales were $15.4 million in Q2 2019 compared to $15.0 million in Q2 2018.
- The Company incurred an operating loss of $264,000 in Q2 2019 compared to an operating loss of $2.7 million in Q2 2018.
- Net income was $2.8 million, or $0.30 per diluted share in Q2 2019, compared to a net loss of $2.6 million, or ($0.29) per diluted share, in Q2 2018. The net income increase was due in large part to the gain on the April 2019 Suttle sale of its FutureLink fiber business line.

Forward-looking statements

In this report and, from time to time, in reports filed with the Securities and Exchange Commission ("SEC"), in press releases, and in other communications to shareholders or the investing public, the Company may make "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. We may make these forward-looking statements concerning possible or anticipated future financial performance, business activities, plans, pending claims, investigations or litigation, which are typically preceded by the words "believes," "expects," "anticipates," "intends" or similar expressions. For these forward-looking statements, the Company claims the protection of the safe harbor for forward-looking statements contained in federal securities laws. Shareholders and the investing public should understand that these forward-looking statements are subject to risks and uncertainties that could cause actual performance, activities, anticipated results, outcomes or plans to differ significantly from those indicated in the forward-looking statements. These risks and uncertainties include, but are not limited to:

**General Risks and Uncertainties:**

- The ability of the Company’s four operating units to each function in an efficient and cost-effective manner, under the oversight of the CSI parent;
- The ability of our four business units to operate profitably;
- The ability of the Special Committee of the Board of Directors to develop strategic options for the Company and the Company’s ability to implement these strategies;
- The impact of changing government expenditures in our markets;
- The fact that the sale of the Company’s Minnetonka headquarters is subject to contingencies, some of which are beyond the Company’s control; and
- The fact that our information technology systems may be exposed to various cybersecurity risks and other disruptions that could impair our ability to operate.

**Transition Networks Risks and Uncertainties:**

- The ability of Transition Networks to develop and sell new products for new and existing markets at a level adequate to counter the decline in sales of its traditional products;
- Transition Networks’ ability to manufacture and deliver its POE+ (Power-over-Ethernet) switches in a timely manner to meet its 2019 obligations under a contract, through a distributor, with a major metropolitan DOT agency;
- Transition Networks’ reliance on contract manufacturers and OEMs to supply it with components and products in a timely manner as Transition Networks develops and introduces new products; and
- Transition Networks’ ability to manage its inventory of components and finished products is complex and complicated by its need to maintain a significant inventory of components that (i) are in short supply, (ii) have been discontinued by the component manufacturer, (iii) must be purchased in bulk to obtain favorable pricing, or (iv) require long lead times. These factors may result in Transition Networks purchasing and maintaining significant amounts of inventory, that if not used or expected to be used based on anticipated production requirements, (i) may become excess or obsolete and (ii) could result in sales price reductions or inventory write-downs that could adversely affect Transition Networks’ business and results of operations.

**Suttle Risks and Uncertainties:**

- Suttle’s dependence upon its sales to a small number of major communication service providers and these providers’ continued investment and deployment into building and maintaining their networks;
- Volatility in purchases of Suttle’s products by major communication service providers as well as continuing pricing pressure that adversely affects Suttle’s margins;

- Suttle's ability to develop and sell new product solutions for "Suttle Home, Securely Wired" applications to offset declining sales and lower or fluctuating gross margins in its legacy products;

- Suttle's ability to perform its obligations under a Transition Services Agreement under which Suttle agreed to manufacture products related to the FutureLink™ Fiber business line until September 30, 2019, to ensure seamless supply to the customer base.

- Suttle's ability to utilize its production capacity profitably; and

- The fact that following the April 2019 sale of its FutureLink business, the Company expects Suttle's sales and operating income to continue decline and that the Company is exploring options for the remainder of this business.

**JDL Technologies Risks and Uncertainties:**

- JDL's ability to continue to obtain and manage the historically fluctuating business from its traditional South Florida school district customer in light of continuing delays in the government funding of this customer and JDL's ability to expand to other educational prospects;

- JDL's ability to profitably increase its business serving small and medium-sized commercial businesses; and

- JDL's ability to establish and maintain a productive and efficient workforce.

**Net2Edge's Risks and Uncertainties:**

- Net2Edge's ability to develop, field test, manufacture and sell new products in sufficient quantities to achieve profitability; and

- Net2Edge's ability to sustain meaningful product differentiation and achieve substantial gross margins.

The Company discusses these and other risk factors from time to time in its filings with the SEC, including risk factors presented under Item 1A of the Company's most recently filed Annual Report on Form 10-K and Quarterly Reports on Form 10-Q.

**Company Results**

Three Months Ended June 30, 2019 Compared to
Three Months Ended June 30, 2018

Consolidated sales increased 2% slightly in the second quarter of 2019 to $15,400,000 compared to $15,038,000 in the same period of 2018. Consolidated operating loss in the second quarter of 2019 was $264,000 compared to an operating loss of $2,722,000 in the second quarter of 2018. Net income in the second quarter of 2019 was $2,773,000 or $0.30 per share compared to net loss of $2,642,000 or $ (0.29) per share in the second quarter of 2018. The net income increase was due in large part to the gain on the April 2019 Suttle sale of its FutureLink fiber business line.

**Transition Networks Results**

Transition Networks sales increased 17% to $9,175,000 in the second quarter of 2019 compared to $7,834,000 in 2018. Transition Networks organizes its sales force by vertical markets and segments its customers geographically. Second quarter sales by region are presented in the following table:

| | Transition Networks Sales by Region | |
|---|---|---|
| | 2019 | 2018 |
| North America | $ 8,052,000 | $ 6,450,000 |
| Rest of World | 672,000 | 864,000 |
| Europe, Middle East, Africa ("EMEA") | 451,000 | 520,000 |
| | $ 9,175,000 | $ 7,834,000 |

The following table summarizes Transition Networks' 2019 and 2018 second quarter sales by its major product groups:

| | Transition Networks Sales by Product Group | |
|---|---|---|
| | 2019 | 2018 |
| Media converters | $ 4,683,000 | $ 4,492,000 |
| Ethernet switches and adapters | 2,831,000 | 1,827,000 |
| Other products | 1,661,000 | 1,515,000 |
| | $ 9,175,000 | $ 7,834,000 |

Sales in North America increased $1,602,000, or 25%, primarily due to more typical buying patterns as compared to 2018, where we experienced slow demand from a carrier customer and disruptions in our product supply. International sales decreased $261,000, or 19%, primarily due to weakness in certain global markets and in ROW where a carrier customer is now being serviced by our Net2Edge business unit. Media converter sales increased 4% or $191,000 due to more traditional buying patterns by a carrier customer. Sales of Ethernet switches and adapters increased 55% or $1,004,000 related to the introduction of new products. All other product sales increased 10% or $146,000 due to strong sales of our accessory product line.

Gross profit on second quarter sales increased to $3,943,000 in 2019 as compared to $3,507,000 in 2018. Gross margin decreased to 43.0% in the second quarter of 2019 from 44.8% in 2018 due primarily to inventory adjustments and higher royalty expenses. Selling, general and administrative expenses increased 9% to $3,575,000, or 39.0% of sales, in the second quarter of 2019 compared to $3,266,000, or 41.7% of sales, in 2018 due to higher employee related expenses and the timing of new employee hires.

Transition Networks had operating income of $368,000 in the second quarter of 2019 compared to operating income of $241,000 in 2018.

**Suttle Results**

Suttle sales decreased 19% in the second quarter of 2019 to $4,747,000 compared to $5,873,000 in the same period of 2018 due mainly to the sale of the FutureLink fiber business line, reduced spend from a Tier 1 telecommunications provider, and a decrease in DSL products sold internationally.

Sales by customer groups in the second quarter of 2019 and 2018 were:

| | Suttle Sales by Customer Group | |
|---|---|---|
| | 2019 | 2018 |
| Communication service providers | $ 3,367,000 | $ 4,500,000 |
| International | 109,000 | 766,000 |
| Distributors | 568,000 | 607,000 |
| Other | 703,000 | — |
| | $ 4,747,000 | $ 5,873,000 |

Suttle's sales by product groups in second quarter of 2019 and 2018 were:

| | Suttle Sales by Product Group | |
|---|---|---|
| | 2019 | 2018 |
| Structured cabling and connecting system products | $ 3,766,000 | $ 5,169,000 |
| DSL and other products | 981,000 | 704,000 |
| | $ 4,747,000 | $ 5,873,000 |

Sales to communication service providers decreased 25% in the second quarter of 2019 due to the sale of the FutureLink fiber business line and a shift in purchasing decisions from Tier 1 telecommunications suppliers to installers. Sales to communication service providers accounted for 71% of Suttle's sales in the second quarter of 2019 compared to 77% of sales in 2018. Sales to distributors decreased 6% in the second quarter of 2019 due to the sale of the FutureLink product line, and accounted for 12% and 10% of sales in the second quarters of 2019 and 2018, respectively. International sales decreased 86% in the second quarter of 2019 due to lower sales of DSL products, and accounted for 2% of Suttle's second quarter 2019 sales. Other sales were $703,000 in the second quarter of 2019 and consisted of transition service revenue per the Transition Services Agreement as a result of the sale of the FutureLink fiber business line.

Sales of structured cabling and connecting system products decreased 27% in the second quarter of 2019 due to the sale of the FutureLink fiber business line. Sales of DSL and other products increased 39% in the first half of 2019 due to transition service revenue per the Transition Services Agreement as a result of the sale of the FutureLink product line, partially offset by a decline in DSL product sold internationally.

Suttle's gross profit increased 220% in the second quarter of 2019 to $1,467,000 compared to $459,000 in the same period of 2018. Gross margin increased to 30.9% from 7.8% in the same period of 2018 due to lower inventory write-downs, workforce reductions, and product price increases. Selling, general and administrative expenses decreased 51% to $938,000, or 19.8% of sales, in the second quarter of 2019 compared to $1,903,000, or 32.4% of sales, in the same period in 2018 due primarily to workforce reductions made at the end of 2018.

Suttle incurred operating income of $529,000 in the second quarter of 2019 compared to an operating loss of $1,444,000 in 2018.

As noted above in Note 16, on April 5, 2019, the Company sold its Suttle FutureLink™ Fiber business line, including inventory, equipment, and customer relationships, to PPC Broadband Inc. ("PPC"). The transaction was structured as an Asset Purchase Agreement with a simultaneous signing and closing. The sale price was $5,000,000 cash and the Company recognized a gain of $2,967,000 on the sale of the assets.

**JDL Technologies Results**

JDL Technologies sales increased 4% to $951,000 in the second quarter of 2019 compared to $913,000 in 2018.

JDL's revenues by customer group were as follows:

| | JDL Revenue by Customer Group | |
|---|---|---|
| | 2019 | 2018 |
| Education | $ 295,000 | $ 280,000 |
| Healthcare and commercial clients | 656,000 | 633,000 |
| | $ 951,000 | $ 913,000 |

Revenues from the education sector increased $15,000 or 5% in the second quarter of 2019 as compared to the 2018 second quarter. While slightly higher than the preceding year, sales were below expectations due to ongoing funding related delays at our largest education customer. Revenue from sales to small and medium-sized commercial businesses ("SMBs"), which are primarily healthcare and commercial clients, increased $23,000, or 4% due to service expansion and rate increases in our commercial services division.

Gross profit increased 249% to $251,000 in the second quarter of 2019 compared to $72,000 in the same period in 2018. Gross margin increased to 26.4% in the second quarter of 2019 compared to 7.9% in 2018 due to a change in product mix from product only sales in 2018 to product installation revenue in 2019. Selling, general and administrative expenses decreased 22% in the second quarter of 2019 to $331,000, or 34.8% of sales, compared to $422,000, or 46.2% of sales, in 2018 due to cost saving measures put in place and lower facility costs due to an office move during 2019.

JDL Technologies reported an operating loss of $80,000 in the second quarter of 2019 compared to an operating loss of $350,000 in the same period of 2018

**Net2Edge Results**

Net2Edge's sales increased 17% to $796,000 in the second quarter of 2019 compared to $681,000 in 2018 primarily due to revenue from established CSI accounts with new higher featured products. Gross profit increased 41% to $253,000 in the second quarter of 2019 compared to $180,000 in the same period of 2018. Gross margin increased to 31.8% in 2019 from 26.4% in 2018 due to favorable product mix at a key carrier customer. Selling, general and administrative expenses decreased 7% in 2019 to $760,000 compared to $820,000 in 2018 due to a reduction in selling expenses. Net2Edge reported an operating loss of $507,000 in the second quarter of 2019 compared to an operating loss of $640,000 in the same period of 2018.

**Income Taxes**

The Company's income before income taxes was $2,780,000 in the second quarter of 2019 compared to a loss before income taxes of $2,653,000 in the second quarter of 2018. The Company's effective income tax rate was 0.2% in the second quarter of 2019 and 0.4% in 2018.

Six Months Ended June 30, 2019 Compared to

Six Months Ended June 30, 2018

Consolidated sales increased 1% in the first half of 2019 to $32,123,000 compared to $31,812,000 in the same period of 2018. Consolidated operating loss in the first half of 2019 was $83,000 compared to an operating loss of $4,696,000 in the first half of 2018. Net income in the first half of 2019 was $3,013,000 or $0.33 per share compared to a net loss of $4,501,000 or $ (0.50) per share in the first half of 2018.

**Transition Networks Results**

Transition Networks sales increased 6% to $18,065,000 in the first half of 2019 compared to $16,988,000 in 2018. Transition Networks organizes its sales force by vertical markets and segments its customers geographically. First half sales by region are presented in the following table:

| | Transition Networks Sales by Region | |
|---|---|---|
| | **2019** | **2018** |
| North America | $ 14,963,000 | $ 14,092,000 |
| Rest of World | 1,396,000 | 1,840,000 |
| Europe, Middle East, Africa (“EMEA”) | 1,706,000 | 1,056,000 |
| | $ 18,065,000 | $ 16,988,000 |

The following table summarizes Transition Networks’ 2019 and 2018 first half sales by its major product groups:

| | Transition Networks Sales by Product Group | |
|---|---|---|
| | **2019** | **2018** |
| Media converters | $ 10,061,000 | $ 9,677,000 |
| Ethernet switches and adapters | 4,831,000 | 4,086,000 |
| Other products | 3,173,000 | 3,225,000 |
| | $ 18,065,000 | $ 16,988,000 |

Sales in North America increased $871,000, or 6%, primarily due to a return to more traditional buying patterns as compared to the first half of 2018 and the resolution of product supply issues experienced in the prior year. International sales increased $206,000, or 7%, primarily due to a significant project with a customer in our EMEA region for media converter products in the first quarter of this year, partially offset by weakness in our ROW region. Media converter sales increased 4% or $384,000 due to the large EMEA project in the first quarter. Sales of Ethernet switches and adapters increased 18% or $745,000 due to strong demand for new products in North America. All other product sales decreased 2% or $52,000 due mainly to slower activity in our ancillary products business during the first quarter.

Gross profit on first half sales increased 4% to $7,697,000 in 2019 as compared to $7,434,000 in 2018. Gross margin decreased to 42.6% in the first half of 2019 from 43.8% in 2018 primarily due to higher inventory reserve adjustments and product mix related to a large project in the EMEA region. Selling, general and administrative expenses increased 8% to $7,270,000, or 40.2% of sales, in the first half of 2019 compared to $6,731,000, or 39.6% of sales, in 2018 due to higher employee related expenses and an increase in engineering expenses related to prototype development.

Transition Networks had operating income of $427,000 in the first half of 2019 compared to operating income of $703,000 in 2018.

**Suttle Results**

Suttle sales decreased 20% in the first half of 2019 to $10,268,000 compared to $12,846,000 in the same period of 2018 due to mainly to the sale of the FutureLink fiber business line and reduced spend from Tier 1 telecommunications providers, volume declines in legacy products, and a shift in purchasing decisions from Tier 1 telecommunications suppliers to installers.

Sales by customer groups in the first half of 2019 and 2018 were:

| | Suttle Sales by Customer Group | |
|---|---|---|
| | 2019 | 2018 |
| Communication service providers | $ 7,958,000 | $ 10,447,000 |
| International | 508,000 | 1,346,000 |
| Distributors | 1,099,000 | 1,053,000 |
| Other | 703,000 | — |
| | $ 10,268,000 | $ 12,846,000 |

Suttle’s sales by product groups in first half of 2019 and 2018 were:

| | Suttle Sales by Product Group | |
|---|---|---|
| | 2019 | 2018 |
| Structured cabling and connecting system products | $ 8,843,000 | $ 11,742,000 |
| DSL and other products | 1,425,000 | 1,104,000 |
| | $ 10,268,000 | $ 12,846,000 |

Sales to communication service providers decreased 24% in the first half of 2019 due to the sale of the FutureLink fiber business line, reduced spend from Tier 1 telecommunications providers, and volume declines in legacy products. Sales to communication service providers accounted for 78% of Suttle’s sales in the first half of 2019 compared to 81% of sales in 2018. Sales to distributors increased 4% in the first half of 2019 due to the Company’ success in selling product through to installers, who have increasingly become Tier 1 suppliers, and accounted for 11% and 8% of sales in the first six months of 2019 and 2018, respectively. International sales decreased 62% in the first half of 2019 due to a decrease in legacy DSL product sales in Latin America, and accounted for 5% of Suttle’s first half 2019 sales. Other sales increased $703,000 in the first half of 2019 due to transition service revenue per the Transition Services Agreement as a result of the sale of the FutureLink fiber business line.

Sales of structured cabling and connecting system products decreased 25% in the first half of 2019 due to the sale of the FutureLink fiber business line and a shift in purchasing decisions from Tier 1 telecommunications suppliers to installers. Sales of DSL and other products increased 29% in the first half of 2019 due to transition service revenue per the Transition Services Agreement as a result of the sale of the FutureLink fiber business line, partially offset by a decline in DSL product sold internationally.

Suttle’s gross profit increased 78% in the first half of 2019 to $3,268,000 compared to $1,834,000 in the same period of 2018. Gross margin increased to 31.8% from 14.3% in the same period of 2018 due to overall favorable product mix changes, price increases at certain Tier 1 suppliers, workforce reductions made at the end of 2018, and lower inventory adjustments. Selling, general and administrative expenses decreased 49% to $1,996,000, or 19.4% of sales, in the first half of 2019 compared to $3,877,000, or 30.2% of sales, in the same period in 2018 due primarily to workforce reductions made at the end of 2018.

Suttle incurred operating income of $1,272,000 in the first half of 2019 compared to an operating loss of $2,043,000 in 2018.

As noted above in Note 16, on April 5, 2019, the Company sold its Suttle FutureLink™ Fiber business line, including inventory, equipment, and customer relationships, to PPC Broadband Inc. ("PPC"). The transaction was structured as an Asset Purchase Agreement with a simultaneous signing and closing. The sale price was $5,000,000 cash and the Company recognized a gain of $2,967,000 on the sale of the assets.

**JDL Technologies Results**

JDL Technologies sales increased 95% to $3,160,000 in the first half of 2019 compared to $1,622,000 in 2018.

JDL's revenues by customer group were as follows:

| | JDL Revenue by Customer Group | |
|---|---|---|
| | 2019 | 2018 |
| Education | $ 1,768,000 | $ 388,000 |
| Healthcare and commercial clients | 1,392,000 | 1,234,000 |
| | $ 3,160,000 | $ 1,622,000 |

Revenues from the education sector increased $1,380,000 or 356% in the first half of 2019 as compared to the 2018 first half due to the resumption of scheduled education projects funded by the federal government that were delayed in the prior year. Revenue from sales to small and medium-sized commercial businesses ("SMBs"), which are primarily healthcare and commercial clients, increased $158,000, or 13% due to ongoing efforts to expand managed services and infrastructure sales to these markets.

Gross profit increased 1974% to $1,120,000 in the first half of 2019 compared to $54,000 in the same period in 2018. Gross margin increased to 35.4% in the first half of 2019 compared to 3.3% in 2018 due to the increase in revenue in our education sector and the prior year having certain fixed costs on lower revenue. Selling, general and administrative expenses decreased 16% in the first half of 2019 to $707,000, or 22.4% of sales, compared to $845,000, or 52.1% of sales, in 2018 due to cost saving measures put in place, lower facility costs due to an office move during 2019, and lower selling and marketing spend.

JDL Technologies reported operating income of $413,000 in the first half of 2019 compared to an operating loss of $791,000 in the same period of 2018

**Net2Edge Results**

Net2Edge's sales increased 47% to $1,244,000 in the first half of 2019 compared to $846,000 in 2018 primarily due to revenue from established CSI accounts with new higher featured products. Gross profit increased 67% to $473,000 in the first half of 2019 compared to $283,000 in the same period of 2018. Gross margin increased to 38.0% in 2019 from 33.5% in 2018 due to favorable product mix at a key carrier customer. Selling, general and administrative expenses decreased 13% in 2019 to $1,508,000 compared to $1,724,000 in 2018 due to a reduction in selling expenses. Net2Edge reported an operating loss of $1,035,000 in the first half of 2019 compared to an operating loss of $1,441,000 in the same period of 2018.

**Income Taxes**

The Company's income before income taxes was $2,995,000 in the first half of 2019 compared to a loss before income taxes of $4,505,000 in the first half of 2018. The Company's effective income tax rate was (0.6%) in the first half of 2019 and 0.1% in 2018. This effective tax rate for 2019 differs from the federal tax rate of 21% due to state income taxes, foreign tax rate differences, foreign losses not deductible for U.S. income tax purposes, the effect of uncertain income tax positions, stock compensation shortfalls, provision true-ups, and changes in valuation allowances related to deferred tax assets. As of December 31, 2018, the Company had a federal net operating loss carryforward from 2015 through 2018 activity of approximately $15,264,000 that is available to offset future taxable income and begins to expire in 2035.

Liquidity and Capital Resources

As of June 30, 2019, the Company had $17,779,000 in cash, cash equivalents, restricted cash, and investments. Of this amount, $9,540,000 was invested in short-term money market funds that are not considered to be bank deposits and are not insured or guaranteed by the FDIC or other government agency. These money market funds seek to preserve the value of the investment at $1.00 per share; however, it is possible to lose money investing in these funds. The remainder in cash and cash equivalents is operating cash. The Company also had $4,001,000 in investments consisting of commercial paper and corporate notes and bonds that are traded on the open market and are classified as available-for-sale at June 30, 2019.

The Company had working capital of $35,116,000 at June 30, 2019, consisting of current assets of approximately $44,026,000 and current liabilities of $8,910,000 compared to working capital of $30,695,000 at December 31, 2018 consisting of current assets of $42,335,000 and current liabilities of $11,640,000.

Cash flow provided by operating activities was approximately $2,400,000 in the first half of 2019 and $2,481,000 used in the same period of 2018. Significant working capital changes from December 31, 2018 to June 30, 2019 included a decrease in accounts receivable of $2,488,000, a decrease in inventories of $1,487,000 and a decrease in accounts payable of $1,908,000.

Net cash provided by investing activities was $657,000 in first half of 2019 compared to $1,140,000 used in 2018, due to proceeds from the sale of the FutureLink business line, partially offset by additional investment purchases.

Net cash used in financing activities was $324,000 in the second three months of 2019 compared to $737,000 used in financing activities in 2018. Cash dividends paid on common stock decreased to $371,000 in 2019 ($0.04 per common share) from $761,000 in 2018 ($0.08 per common share). Proceeds from common stock issuances, principally shares sold to the Company's Employee Stock Ownership Plan and issued under the Company's Employee Stock Purchase Plan, totaled approximately $49,000 in 2019 and $53,000 in 2018. The Company did not repurchase any shares in 2019 or 2018 under the Board-authorized program. At June 30, 2019, Board of Director authority to purchase approximately 411,910 additional shares remained in effect. The Company acquired $2,000 and $28,000 in 2019 and 2018, respectively, of Company stock from employees to satisfy withholding tax obligations related to share-based compensation, pursuant to terms of Board and shareholder-approved compensation plans.

The Company has a $15,000,000 line of credit from Wells Fargo Bank. Interest on borrowings on the credit line is at LIBOR plus 2.0% (4.4% at June 30, 2019). The Company had no outstanding borrowings against the line of credit at June 30, 2019. The credit agreement expires August 12, 2021 and is secured by assets of the Company.

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.

Critical Accounting Policies

Our critical accounting policies, including the assumptions and judgments underlying them, are discussed in our 2018 Form 10-K in Note 1 Summary of Significant Accounting Policies included in our Consolidated Financial Statements. In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842), which amends existing guidance and requires an entity to recognize both assets and liabilities arising from financing and operating leases, along with additional qualitative and quantitative disclosures. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within that reporting period, and early adoption is permitted. The Company adopted the accounting standard effective January 1, 2019. Please see Note 3 for the required disclosures related to the impact of adopting this standard. There were no other significant changes to our critical accounting policies during the six months ended June 30, 2019.

The Company's accounting policies have been consistently applied in all material respects and disclose matters such as allowance for doubtful accounts, sales returns, inventory valuation, warranty expense, income taxes, revenue recognition, asset impairment recognition and foreign currency translation. On an ongoing basis, we evaluate our estimates based on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the result of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. Management reviews these estimates and judgments on an ongoing basis.

Recently Issued Accounting Pronouncements

Recently issued accounting standards and their estimated effect on the Company's condensed consolidated financial statements are also described in Note 17, Recent Accounting Pronouncements, to the Condensed Consolidated Financial Statements.

## Item 3. Quantitative and Qualitative Disclosures about Market Risk.

The Company has no freestanding or embedded derivatives. The Company's policy is to not use freestanding derivatives and to not enter into contracts with terms that cannot be designated as normal purchases or sales.

The vast majority of our transactions are denominated in U.S. dollars; as such, fluctuations in foreign currency exchange rates have historically not been material to the Company. At June 30, 2019 our bank line of credit carried a variable interest rate based on LIBOR plus 2.0%. As noted above, we had no outstanding borrowings at June 30, 2019.

Based on the Company's operations, in the opinion of management, no material future losses or exposure exist relative to market risk.

## Item 4. Controls and Procedures

*(a) Evaluation of Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) that are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this report. Based on that evaluation, as detailed below, management concluded that the Company's disclosure controls and procedures are effective.

*(b) Changes in Internal Controls*

Beginning January 1, 2019, we adopted ASU No. 2016-02, "Leases (Topic 842)," which resulted in recording lease liabilities and right-of-use assets on our consolidated balance sheet. ASC 842 requires management to make significant judgments and estimates. As a result, we implemented changes to our internal controls related to leases for the six months ended June 30, 2019. These changes include implementing updated processes and controls affected by ASC 842. There was no other change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. As disclosed in our Annual Report on Form 10-K for the year ended December 31, 2018, we concluded that our internal control over financial reporting was effective.

PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

Not Applicable.

## Item 1A. Risk Factors

Not Applicable.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not Applicable.

## Item 3. Defaults Upon Senior Securities

Not Applicable.

## Item 4. Mine Safety Disclosures

Not Applicable.

## Item 5. Other Information

Not Applicable.

## Item 6. Exhibits.

The following exhibits are included herein:

| | |
|---|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rules 13a-14 and 15d-14 of the Exchange Act). |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rules 13a-14 and 15d-14 of the Exchange Act). |
| 32. | Certifications pursuant Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. §1350). |
| 99.1 | Communications Systems, Inc. Press Release dated July 29, 2019 announcing Major Metropolitan DOT selected CSI subsidiary Transition Networks for Smart City IoT Project. |
| 99.2 | Communications Systems, Inc. Press Release dated July 31, 2019 announcing 2019 Second Quarter Results. |

Signatures

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

| | | |
|---|---|---|
| | | Communications Systems, Inc. |
| | By | /s/ Roger H.D. Lacey |
| | | Roger H.D. Lacey |
| Date: August 2, 2019 | | Chief Executive Officer |
| | | /s/ Mark Fandrich |
| | | Mark Fandrich |
| Date: August 2, 2019 | | Chief Financial Officer |

**Exhibit 31.1**

CERTIFICATION

I, Roger H.D. Lacey certify that:

1. I have reviewed this quarterly report on Form 10-Q of Communications Systems, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal controls over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By /s/ Roger H.D. Lacey
Roger H.D. Lacey
Chief Executive Officer

Date: August 2, 2019

**Exhibit 31.2**

CERTIFICATION

I, Mark Fandrich, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Communications Systems, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal controls over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting

By /s/ Mark Fandrich
Mark Fandrich
Chief Financial Officer

Date: August 2, 2019

**Exhibit 32**

CERTIFICATION

The undersigned certify pursuant to 18 U.S.C. § 1350, that:

(1) The accompanying Quarterly Report on Form 10-Q for the periods ended June 30, 2019, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the accompanying Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

| | | |
|---|---|---|
| | By | /s/ Roger H.D. Lacey |
| | | Roger H.D. Lacey |
| Date: August 2, 2019 | | Chief Executive Officer |
| | By | /s/ Mark Fandrich |
| | | Mark Fandrich |
| Date: August 2, 2019 | | Chief Financial Officer |

**Exhibit 99.1**

**Communications Systems' Subsidiary Transition Networks Selected by Major Metropolitan DOT Agency for Smart City IoT Project Valued at $7 Million**

*Transition Networks' Unique Technology Simplifies Customer Experience to Connect and Power Thousands of Traffic Intersections Deploying Intelligent Transportation Devices*

Minneapolis, MN – July 29, 2019 — Communications Systems, Inc. (NASDAQ: JCS) ("CSI" or the "Company"), a global provider of enterprise network infrastructure, IoT and edge connectivity, and management of IT services, today announced that its wholly-owned subsidiary Transition Networks, Inc. was selected by a major metropolitan transportation agency to connect, power and manage traffic data via its hardened TAA compliant, PoE+ (Power-over-Ethernet) switches. This application brings intelligent transportation infrastructure citywide and advances Transition Networks' strategy into creating smart city IoT (Internet of Things) solutions. Transition Networks' portion of the project is valued at $7 million and is expected to ship during 2019.

As more transportation agencies look to use actionable intelligence to monitor trends and improve service, they are deploying smart, energy efficient technology and communication devices to assess traffic congestion, safety, pedestrian counts and more. With the number of IoT devices predicted to grow to exponentially, Transition Networks' unique PoE solutions will continue to be a critical component of the IoT and smart city ecosystem saving time, reducing costs and conserving energy for cities while increasing safety, security, and conveniences for citizens.

As previously announced, CSI's restructuring efforts to shift our focus towards higher-margin and faster growing markets such as IoT and network edge management have positioned us to develop products with unique features that set us apart from other suppliers. Auto Power Reset (APR), which automatically reboots an unresponsive PoE powered device connected to the switch meets critical needs for customers.

Transition Networks' embedded Device Management System (DMS) software, which creates an interactive map for agencies to see all of their connected devices, quickly pinpoint issues and allows the administrator to immediately take action. Both DMS and APR have been important features for several other smart city projects and were key differentiators when the customer chose the Transition Networks' solution.

"This project's impact on smart city infrastructure will be a guide for city planners and integrators as they look to harness the benefits that smart city switch technology provides including simplified network management and significant cost-savings," says Scott Otis, Transition Networks' President and General Manager. "We are continually developing innovative solutions to advance our position as an integral component of the IoT and smart city ecosystem."

For more information on Transition Networks' intelligent transportation solutions visit theirwebsite.

**About Transition Networks**

Transition Networks provides IoT and edge connectivity solutions to advance intelligent networks globally for enterprises, integrators, service providers, federal agencies, and the military. Addressing the demands of smart city and hybrid networks, Transition Networks' PoE switches and converters, adapters, and optics integrate easily into smart network applications in commercial and hardened environments. Transition Networks is a U.S.-based company known for expert customer-centric service and built to last, TAA-compliant products with 30 years of experience serving customers in 70 countries, including more than two thirds of the Fortune 100 companies. Transition Networks is a Communications Systems Inc. company (NASDAQ: JCS). For more information, visit 10900 Red Circle Drive Minnetonka, MN 55343, call +1.952.996.7600, or visit http://www.transition.com.

-more-

**About Communications Systems**

Communications Systems, Inc. (NASDAQ: JCS) provides connectivity infrastructure and services for global deployments of broadband networks. Focusing on innovative, cost-effective solutions, CSI provides customers the ability to deliver, manage, and optimize their broadband network services and architecture. From the integration of fiber optics in any application and environment to efficient home voice and data deployments to optimization of data and application access, CSI provides tools for maximum utilization of the network from the edge to the user. With partners and customers in over 50 countries, CSI has built a reputation as a reliable global innovator focusing on quality and customer service. For more information, please visit our website at http://www.commsystems.com/CSI.

**Forward Looking Statement**

This press release includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding future financial performance, future growth and future acquisitions. These statements are based on Communications Systems' current expectations or beliefs and are subject to uncertainty and changes in circumstances. Actual results may vary materially from those expressed or implied by the statements here due to changes in economic, business, competitive or regulatory factors, and other risks and uncertainties affecting the operation of Communications Systems' business. These risks, uncertainties and contingencies are presented in the Company's Annual Report on Form 10-K and, from time to time, in the Company's other filings with the Securities and Exchange Commission. The information set forth herein should be read in light of such risks. Further, investors should keep in mind that the Company's financial results in any particular period may not be indicative of future results. Communications Systems is under no obligation to, and expressly disclaims any obligation to, update or alter its forward-looking statements, whether as a result of new information, future events, changes in assumptions or otherwise.

**Contacts:**

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Lena Cati
Vice President
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Exhibit 99.2

**FOR IMMEDIATE RELEASE**

**COMMUNICATIONS SYSTEMS, INC. REPORTS SECOND QUARTER FINANCIAL RESULTS**

**Higher sales and favorable product mix resulted in significantly narrowed operating loss**

**Sale of FutureLink product line generates Q2 2019 EPS of $0.30**

**Minnetonka, MN – July 31, 2019 – Communications Systems, Inc. (NASDAQ: JCS) ("CSI" or the "Company")** a global provider of enterprise network infrastructure, IoT and edge connectivity, and IT managed services, today announced financial results for the second quarter ("Q2") ended June 30, 2019, including a discussion of results of operations by segment.

**Second Quarter 2019 Summary**

- Q2 2019 consolidated sales were $15.4 million and increased by 2.4%, as compared to sales of $15.0 million in Q2 2018; the increase was due to higher sales at Transition Networks, Net2Edge and JDL segments, offset by lower sales at Suttle.

- Q2 2019 consolidated gross profit increased by 43% to $5.7 million, from $4.0 million in the same period of 2018. Gross margin improved to 37.1% in Q2 2019 from 26.5% in Q2 2018 driven by a favorable mix of products and services and lower inventory adjustments.

- Q2 2019 consolidated operating loss narrowed substantially to $264,000, as compared to the Q2 2018 consolidated operating loss of $2.7 million. Of note, effective January 1, 2019, the Company realigned its financial reporting to exclude certain corporate general and administrative expenses from costs allocated to its business segments, which are reported as "Other" in the segment information in our Form 10-Q and also reported below. Additionally, corporate general and administrative expenses for the Q2 2018 reported in this press release have been reclassified to reflect this change.

  - Transition Networks' Q2 2019 operating income increased by 53% to $368,000, as compared to operating income of $241,000 in Q2 2018.

  - Suttle's Q2 2019 operating income was $529,000, as compared to an operating loss of $1.4 million in Q2 2018.

  - JDL Technologies' Q2 2019 operating loss narrowed to $80,000 from an operating loss of $350,000 in Q2 2018.

  - Net2Edge's Q2 2019 operating loss narrowed to $507,000 from an operating loss of $640,000 in Q2 2018.

- Other Q2 2019 operating expenses totaled $574,000 as compared to $529,000 in Q2 2018.

- During Q2 2019 the Company's Suttle operating segment sold its FutureLink™ Fiber product line, including inventory and customer relationships, for $5.0 million, resulting in a non-operating gain of $3.0 million.

- Q2 2019 net income improved to $2.8 million, or $0.30 per diluted share, compared to a net loss of $2.6 million, or $(0.29) per diluted share, in Q2 2018. Although in a positive net income position for Q2 and six months 2019 periods, due to the tax valuation allowance against net operating losses sustained in 2015 through 2018, we have no federal tax expense being recorded for both 2019 reporting periods.

- At June 30, 2019, cash, cash equivalents, restricted cash, and investments totaled $17.8 million and working capital was $35.1 million.

CSI's Chief Executive Officer Roger H.D. Lacey commented, "As expected, Q2 2019 was a solid quarter for CSI. Our total sales increased by 2.4% despite a $1.1 million decrease at Suttle due to the sale of the FutureLink fiber product line at the start of the quarter. Our margin substantially improved due to steps taken to improve our product offering by focusing on higher-margin products and added-value services, improve quality control processes, implement cost savings initiatives for each business unit, and streamline our accounting processes. Our efforts resulted in positive net income for the quarter."

"Going forward, we expect sales to continue to grow and margins to improve at Transition Networks, JDL Technologies and Net2Edge, although quarterly performance may vary due to timing of contracts. Of note, following the sale of the FutureLink business, Suttle's sales and operating income is expected to continue to decline and we are exploring options for the remainder of its business."

Mr. Lacey concluded, "We will continue to execute on our growth strategy, expand our customer base, enlarge our geographic footprint, and transform CSI from a network services and product manufacturing company into a growing and profitable cloud-based IoT and network edge solutions company. This strategy is supported by a strong balance sheet. At June 30, 2019, we had cash, cash equivalents, restricted cash, and investments totaling $17.8 million, working capital of $35.1 million and shareholders' equity of $44.8 million and believe we have adequate cash to finance future plans."

**Q2 2019 Segment Financial Overview**

**Transition Networks**

| (in 000s) | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| **Sales** | $ 9,175 | $ 7,834 | $ 18,065 | $ 16,988 |
| **Gross profit** | 3,943 | 3,507 | 7,697 | 7,434 |
| **Operating income** | 368 | 241 | 427 | 703 |

Q2 2019 sales increased by $1,341,000 or 17% as compared to Q2 2018. Sales in North America increased by $1,602,000, or 25%, primarily due to more typical buying patterns as compared to the same period of 2018, where we experienced slow demand from a carrier customer and disruptions in product supply. International sales decreased by $261,000, or 19%, primarily due to weakness in certain global markets.

Media converter sales increased by 4% or $191,000 due to more typical buying patterns by a carrier customer. Sales of Ethernet switches and adapters increased by 55% or $1,004,000 mainly due to introduction of new products. New product sales, or sales from products introduced within the past three years, were $2.8 million or 30% of Q2 2019 sales. All other product sales increased by 10% or $146,000 due to strong sales of our accessory product line.

Q2 2019 gross profit increased to $3,943,000 as compared to $3,507,000 in Q2 2018, while gross margin decreased to 43.0% from 44.8% in Q2 2018 primarily due to inventory adjustments and higher royalty expenses. Although total Q2 2019 selling, general and administrative expenses increased by 9% to $3,575,000, as compared to $3,266,000 in Q2 2018, due to higher employee related expenses and the timing of new employee hires, as a percentage of sales these expenses decreased to 39.0%, as compared to 41.7% in Q2 2018.

Transition Networks' Q2 2019 operating income increased to $368,000 as compared to $241,000 in Q2 2018.

Mr. Lacey commented, “As announced earlier this week, Transition Networks was selected by a major metropolitan DOT agency to connect, power and manage traffic data via its hardened TAA compliant, PoE+ (Power-over-Ethernet) switches. This project, with estimated revenues of $7 million, is expected to be completed before 2019 year-end and will advance Transition Networks position as an integral component of the IoT and smart city ecosystem. We believe that 2019 will be a year of strong operational performance for Transition Networks.”

**Suttle**

| (in 000s) | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| **Sales** | $ 4,747 | $ 5,873 | $ 10,268 | $ 12,846 |
| **Gross profit** | 1,467 | 459 | 3,268 | 1,834 |
| **Operating income (loss)** | 529 | (1,444) | 1,272 | (2,043) |

As expected, Suttle’s Q2 2019 sales decreased by 19% to $4,747,000 from $5,873,000 in the same period of 2018 due to the sale of the FutureLink fiber business line at the start of the quarter and a decrease in DSL products sold internationally. Sales to communication service providers accounted for 71% of Suttle’s total sales in Q2 2019, as compared to 77% of sales in Q2 2018. Sales to distributors declined by 6% in Q2 2019 due to the April 2019 sale of the FutureLink product line and accounted for 12% and 10% of Suttle’s sales in Q2 2019 and Q2 2018, respectively. International sales decreased by 86% in Q2 2019 due to lower sales of DSL products, and accounted for 2% of Suttle’s Q2 2019 sales. Other sales were $703,000 in Q2 2019 and consisted of transition services delivered under the Transition Services Agreement related to the sale of the FutureLink fiber business line.

Suttle’s Q2 2019 gross profit increased by 220% to $1,467,000 as compared to $459,000 in Q2 2018, due to lower inventory write-downs, workforce reductions, and product price increases, resulting in gross margin of 30.9% as compared to 7.8% in Q2 2018. Selling, general and administrative expenses in Q2 2019 decreased by 51% to $938,000, or 19.8% of sales, as compared to $1,903,000, or 32.4% of sales in Q2 2018 primarily due to sales and administrative workforce reductions made at the end of 2018.

As a result, Suttle reported an operating income of $529,000 in Q2 2019, as compared to an operating loss of $1,444,000 in Q2 2018.

As previously disclosed, on April 5, 2019, the Company sold its Suttle FutureLink™ Fiber business line, including inventory, equipment, and customer relationships, to PPC Broadband Inc., through a transaction structured as an Asset Purchase Agreement. The sale price was $5,000,000 cash and the Company recognized a gain of $2,967,000 on the sale of the assets.

Mr. Lacey commented, “Restructuring completed in Q4 2018 and the sale of the FutureLink business allowed Suttle to experience profitability in the first half of 2019, but we expect that after we fulfill our obligations under the Transition Services Agreement, Suttle’s ongoing operating income will decline and could return to a loss. As previously announced, the Strategic Committee of CSI’s Board of Directors continues to explore options for the remainder of the Suttle business.”

**JDL Technologies**

| (in 000s) | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| **Sales** | $ 951 | $ 913 | $ 3,160 | $ 1,622 |
| **Gross profit** | 251 | 72 | 1,120 | 54 |
| **Operating income (loss)** | (80) | (350) | 413 | (791) |

JDL Technologies Q2 2019 sales were $951,000 and although 4% higher than Q2 2018 sales of $913,000, were below expectations due to funding related delays from our largest education customer. While our customer has confirmed they want proposed projects to be completed, funding needs to be secured before JDL Technologies begins working on these projects. That said, Q2 2019 sales from the education sector increased by $15,000 or 5% as compared to Q2 2018.

Revenue from sales to small and medium-sized commercial businesses, which are primarily healthcare and commercial clients, increased by $23,000, or 4% due to service expansion and rate increases.

JDL Technologies' Q2 2019 gross profit increased by 249% to $251,000 as compared to $72,000 in Q2 2018 due to a change in product mix as the business model shifted from "product only" sales in Q2 2018, to higher margin "product and installation" sales in Q2 2019. Thus Q2 2019 gross margin increased to 26.4% as compared to 7.9% in Q2 2018. Q2 2019 selling, general and administrative expenses decreased by 22% to $331,000, or 34.8% of sales, compared to $422,000, or 46.2% of sales, in Q2 2018 due to cost saving measures put in place and lower facility costs following office relocation in early 2019.

As a result, JDL Technologies' operating loss narrowed to $80,000 in Q2 2019 compared to an operating loss of $350,000 in the same period of 2018.

**Net2Edge**

| (in 000s) | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| **Sales** | $ 796 | $ 681 | $ 1,244 | $ 846 |
| **Gross profit** | 253 | 180 | 473 | 283 |
| **Operating loss** | (507) | (640) | (1,035) | (1,441) |

Net2Edge's sales increased by 17% to $796,000 in Q2 2019 compared to $681,000 in Q2 2018 primarily due to increase in revenue from established CSI accounts with new higher-featured products. Q2 2019 gross profit increased by 41% to $253,000, as compared to $180,000 in the same period of 2018. Gross margin increased to 31.8% in Q2 2019 from 26.4% in Q2 2018 due to a favorable product mix at a key carrier customer. Selling, general and administrative expenses decreased by 7% in Q2 2019 to $760,000, as compared to $820,000 in Q2 2018 due to a reduction in selling expenses as a result of a lower headcount. Thus Net2Edge's operating loss decreased to $507,000 in Q2 2019 compared to an operating loss of $640,000 in the same period of 2018.

**Financial Condition**

CSI's balance sheet at June 30, 2019 included cash, cash equivalents, restricted cash, and investments of $17.8 million, working capital of $35.1 million, and stockholders' equity of $44.8 million.

**Form 10-Q**

For further information, please see the Company's Form 10-Q, which will be filed on or about August 2, 2019.

**About Communications Systems**

Communications Systems, Inc. provides connectivity infrastructure and services for global deployments of broadband networks. Focusing on innovative, cost-effective solutions, CSI provides customers the ability to deliver, manage, and optimize their broadband network services and architecture. From the integration of fiber optics in any application and environment to efficient home voice and data deployments to optimization of data and application access, CSI provides tools for maximum utilization of the network from the edge to the user. With partners and customers in over 50 countries, CSI has built a reputation as a reliable global innovator focusing on quality and customer service.

**Forward-Looking Statements**

This press release includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding future financial performance, future growth and future acquisitions. These statements are based on Communications Systems' current expectations or beliefs and are subject to uncertainty and changes in circumstances. Actual results may vary materially from those expressed or implied by the statements here due to changes in economic, business, competitive or regulatory factors, and other risks and uncertainties affecting the operation of Communications Systems' business. These risks, uncertainties and contingencies are presented in the Company's Annual Report on Form 10-K and, from time to time, in the Company's other filings with the Securities and Exchange Commission. The information set forth herein should be read in light of such risks. Further, investors should keep in mind that the Company's financial results in any particular period may not be indicative of future results. Communications Systems is under no obligation to, and expressly disclaims any obligation to, update or alter its forward-looking statements, whether as a result of new information, future events, changes in assumptions or otherwise.

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**Selected Income Statement Data**

| | Unaudited Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | Jun. 30, 2019 | Jun. 30, 2018 | Jun. 30, 2019 | Jun. 30, 2018 |
| Sales | $ 15,400,076 | $ 15,038,159 | $ 32,123,370 | $ 31,811,844 |
| Gross profit | $ 5,708,002 | $ 3,985,085 | $ 12,134,967 | $ 9,163,704 |
| Operating loss | (264,098) | (2,722,204) | (83,463) | (4,696,424) |
| Income (loss) before income taxes | 2,779,616 | (2,653,035) | 2,994,762 | (4,505,309) |
| Income tax expense (benefit) | 6,438 | (11,525) | (18,529) | (3,955) |
| Net income (loss) | $ 2,773,178 | $ (2,641,510) | $ 3,013,291 | $ (4,501,354) |
| | | | | |
| Basic net income (loss) per share | $ 0.30 | $ (0.29) | $ 0.33 | $ (0.50) |
| Diluted net income (loss) per share | $ 0.30 | $ (0.29) | $ 0.33 | $ (0.50) |
| Cash dividends declared per share | $ 0.02 | $ 0.04 | $ 0.04 | $ 0.08 |
| | | | | |
| Average basic shares outstanding | 9,316,576 | 9,132,855 | 9,246,233 | 9,066,886 |
| Average dilutive shares outstanding | 9,319,106 | 9,132,855 | 9,246,233 | 9,066,886 |

| | Unaudited Jun. 30, 2019 | Dec. 31, 2018 |
|---|---|---|
| Total assets | $ 54,075,694 | $ 53,321,164 |
| Cash, cash equivalents, restricted cash, and investments | 17,779,090 | 11,056,426 |
| Working capital | 35,116,717 | 30,695,322 |
| Property, plant and equipment, net | 9,607,354 | 10,962,239 |
| Long-term liabilities | 392,631 | 28,267 |
| Stockholders’ equity | 44,773,443 | 41,653,127 |