COMMUNICATIONS SYSTEMS INC
Form 10-K
March 15, 2012

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

FORM 10-K

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

For the fiscal year ended December 31, 2011

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 and zip code)
Registrant s telephone number, including area code: (952) 996-1674

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.05 par value	**NASDAQ**
Preferred Stock Purchase Rights	

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES o NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES o NO x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). YES x NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.
See definition of accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Act.

Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o Smaller Reporting Company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately $119,701,000 based upon the closing sale price of the Company s common stock on the NASDAQ on June 30, 2011.

As of March 1, 2012 there were outstanding 8,470,015 shares of the Registrant s common stock.

Documents Incorporated by Reference: Portions of the Company s Proxy Statement for its Annual Meeting of Shareholders to be held on May 22, 2012 are incorporated by reference into Part III of this Form 10-K.

PART I

ITEM 1. BUSINESS
(a) GENERAL DEVELOPMENT 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.), Costa Rica, the United Kingdom (U.K.) and China. CSI is principally engaged through its Suttle and Austin Taylor business units in the manufacture and sale of modular connecting and wiring devices for voice and data communications, digital subscriber line filters, and structured wiring systems and through its Transition Networks business unit in the manufacture and sale of media and rate conversion products for telecommunications networks. Through its JDL Technologies business unit, CSI also provides IT solutions including network design, computer infrastructure installations, IT service management, change management, network security, and network operation services.

The Company maintains a website at www.commsystems.com. Our annual reports on Form 10-K, our quarterly reports on Form 10-Q and our periodic reports on Form 8-K (and any amendments to these reports) are available free of charge by linking from our website to the Securities and Exchange Commission website.

(b) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS

The Company classifies its businesses into four segments: *Suttle*, which manufactures U.S. standard modular connecting and wiring devices for voice and data communications; *Transition Networks,* which designs and markets media conversion products, Ethernet switches, and other connectivity and data transmission products; *Austin Taylor,* which manufactures British standard line jacks, patch panels, metal boxes, distribution and central office frames; and *JDL Technologies, (JDL*), which provides IT solutions. Non-allocated general and administrative expenses are separately accounted for as Other in the Company s segment reporting. There are no material intersegment revenues. Further information regarding the various segments including customer and industry concentration, is set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 11 of the Notes to Consolidated Financial Statements under Item 8, herein.

(c) NARRATIVE DESCRIPTION OF BUSINESS

(1) Information Regarding Business Segments

(i) Suttle

Suttle manufactures and markets copper and fiber connectivity systems, enclosure systems, XDSL filters and splitters, and active technologies for voice, data and video communications under the Suttle brand name in the United States and internationally. Suttle also manufactures and markets a line of residential structured wiring products under the SOHO (Small Office Home Office) Access brand name. Approximately 55% of Suttle s products are manufactured at its plants in Hector, Minnesota (Suttle Apparatus Minnesota Division) and San Jose, Costa Rica (Suttle Costa Rica, S.A.). The other 45% are purchased from offshore contract manufacturers. Segment sales were $36,637,000 (25% of consolidated revenues) in 2011 and $36,562,000 (30% of consolidated revenues) in 2010.

Products

Suttle offers a broad range of critical components for premise and outside plant networking. The company s customer-oriented approach provides right-sized solutions that leverage existing infrastructure and protect investments as markets and technologies grow and change. With over 100 years of knowledge and experience, Suttle is a reliable partner, delivering innovative, flexible, easy-to-use solutions, lower cost of ownership, and solid customer support.

Connectivity:

In the face of changing technology, the right equipment can accommodate upgrades in technology, reducing future as well as current costs. Suttle s passive premise equipment for single family units (SFU) and multi-dwelling units (MDU) dwellings presents a variety of opportunities. In Brownfield applications, Suttle offers innovative new fiber and copper connectivity products that interact easily with existing equipment, reducing the cost of installation. In Greenfield applications, Suttle offers tool-less copper connectivity products that simplify installation and reduce labor costs. These technologies can even allow for customer installation, eliminating the need for a truck roll entirely.

As a leading producer of passive components, Suttle works to understand real-world applications and market needs. Suttle stresses the importance of labor costs and the consequences of premature failure or obsolescence. The company works with major service providers, adapting its connectivity portfolio to changing markets, technologies, and infrastructure.

Suttle is continuing to expand its U.S. manufacturing to maximize flexibility and minimize lead times. It is committed to maintaining both internal and external quality standards as well as industry product specifications. Suttle was one of the first companies to pass the new Telcordia GR-3167 standard for VDSL2 along with the TR-127 for ring trip mitigation allowing our splitters to leverage existing infrastructure for next generation IPTV services. Our focus on quality, product performance and customer support allows us to continue to develop new innovative product solutions.

Home Distribution:

Wiring a home for service can be both costly and time-consuming. Suttle provides complete, cost-effective connectivity solutions that utilize a home s existing wiring. These home distribution products reduce installation time and labor costs. In addition to reducing a service provider s up-front costs, the high throughput of Suttle s solutions helps eliminate potential bottlenecks to future-proof the installation.

Suttle is augmenting over 100 years of home connectivity experience, adding expertise in advanced active home distribution to provide the systems and components that service providers need to compete in today s quickly growing market. These technologies allow service providers to maximize existing infrastructure without sacrificing quality while reducing total cost of infrastructure ownership.

Outside Plant Configurations:

Outside plant can be the most challenging aspect of telephone or cable infrastructure. It must deal with environmental challenges yet be easily accessible. The overall product design can extend the life of the existing network, enhance data speeds, and prevent loss. It can affect all aspects of service implementation, ease of maintenance, and overall cost of labor.

Suttle understands these challenges and knows the importance of total cost of ownership, reliability, and quality of service. Its systems are designed for flexibility in real world applications for both copper and fiber networks.

Markets and Marketing

Suttle markets its connectivity, outside plant configuration, and home distribution products to telecommunications companies globally. Suttle has a long history of selling to some of the largest global providers and it does so by understanding the customer s needs and providing innovative solutions coupled with strong customer support. Additionally, Suttle markets its products to service providers, residential builders, and low voltage installers through distributors and the Company s sales staff.

Suttle reaches its targeted customers through a variety of marketing mediums including trade shows, associations, advertising, social media and the Suttle website, www.suttleonline.com.

Customers

Suttle s customers include the major communication companies globally, including both telephone and cable service provider companies. The Company s major telephone company customers include Verizon, ATT, and CenturyLink (formerly Qwest). Major telephone companies are served directly by Suttle s sales staff and through a select group of distributors. As a group, sales (including DSL) to the major telephone companies, both directly and through distribution, represented 74% of Suttle s sales in 2011 and 70% in 2010.

Other customers include smaller telephone companies, electrical/low voltage contractors, home builders, and a nationwide network of distributors. These customers are served primarily through distributors but are also served directly by Suttle s sales staff. Sales to cable customers and original equipment manufacturers (OEMs) are made through the nationwide network of distributors and through the Suttle sales staff. Sales to OEMs and other distributors were 12% of Suttle s sales in 2011 and 14% in 2010. Sales to international customers and other customers represented 14% of Suttle s sales in 2011 and 16% in 2010.

Competition

Suttle encounters strong competition in all its product lines and competes primarily on the basis of the broad lines of products offered, product performance, quality, price, delivery, and customer support. In addition, distributors of Suttle s products also market products for one or more of these competitors.

Order Book

Suttle manufactures its products on the basis of estimated customer requirements. Outstanding customer orders at March 1, 2012 were approximately $3,250,000 compared to approximately $3,724,000 at March 1, 2011. New orders are generally filled within 60 days. Suttle does not believe its order book is a significant indicator of longer term future results.

Manufacturing and Sources of Supply

Suttle s products are manufactured using plastic or metal parts, wire sub-assemblies, fasteners, brackets, electronic circuit boards and other components, most of which are fabricated by Suttle. There are multiple sources of supply for the materials and parts required and the Company is not dependent upon any single supplier, except that Suttle s corrosion-resistant products use a moisture-resistant gel-filled fig available only from TE Connectivity. Suttle has not generally experienced significant problems in obtaining its required supplies, although from time to time it experiences spot shortages and additional order lead times are required from its offshore suppliers.

Research and Development: Patents

Suttle continually monitors industry requirements and creates new products to improve its existing product line. Although Suttle has historically not relied significantly on patents to protect its competitive position, as a result of duplication of its designs by foreign apparatus manufacturers, Suttle has begun to apply for design patents on a number of its new products.

The Company s Suttle brand name is important to its business. Suttle regularly supports this name by trade advertising and believes it is well known in the marketplace.

(ii) Transition Networks

Transition Networks, Inc. (Transition or Transition Networks) is based in Minnetonka, Minnesota and also maintains operations in China and the U.K. Transition designs, assembles and markets network interface devices (NIDs), media converters, network interface cards (NICs), Ethernet switches, Small Form factor Pluggable modules (SFP), and other connectivity products under the Transition Networks and MILAN brand names. Transition sells its product through distributors, resellers, integrators, and OEMs. These NIDs, media converter and Ethernet Switch products permit voice and data networks to move information between copper-wired equipment and fiber-optic cable. Sales by Transition Networks were $91,450,000 (64% of consolidated sales) in 2011 compared to $67,782,000 (56% of consolidated sales) in 2010. International sales accounted for 15% of Transition s sales, or $14,002,000 in 2011, compared to $11,358,000, or 17% of Transition s sales in 2010.

Products

Transition Networks designs, assembles and sells media converter devices, NIDs, Ethernet switches and other connectivity products that make it possible to transmit telecommunications signals between systems using different types of media (for example, between copper and fiber optic networks). These products enable customers to integrate fiber optics into their existing network infrastructure as their networks grow, and extend data services to customers or remote locations. Protocols supported include Gigabit Ethernet, Fast Ethernet, Ethernet, T1/E1, DS3, RS232, RS485, OC3, OC12, and more. The Company uses proprietary Application Specific Integrated Circuits (ASIC) for development of some products, as well as ASICs from integrated circuit manufacturers such as Marvell® and Broadcomm® for the development of new products. Transition Networks develops product hardware and software internally, and expenses the related costs as they are incurred. In connection with the sale of its hardware products, Transition Networks provides its customers with free operating software. Transition Networks focuses its product development on hardware, with software developed to support hardware sales. The Company has been developing and marketing Ethernet-based networking products for approximately 23 years. Transition Networks continues to develop products that address the enterprise, service provider, industrial, and security markets and, in addition, targets the specific vertical markets of government and education.

Manufacturing and Sources of Supply

Transition Networks outsources most of its manufacturing. In 2011, approximately 67% of its products were manufactured offshore, principally in Asia. Offshore sources of supply are subject to certain risks, including political risk. The balance of its products are manufactured in the United States. The Company has alternate sources of supply for its products and to date has not had problems obtaining necessary product.

Markets and Marketing

Transition Networks products are used in a broad array of markets, including enterprise networks, service providers networks, security and industrial environments such as in manufacturing processes. Transition Networks has a broad customer base and its products are used in a variety of applications.

The media conversion product line addresses and is used in a variety of applications. The ION and Point System chassis-based modular systems are used primarily in telecommunications closets for high-density applications and when multiple protocols need to be supported. Stand-alone media converters are used typically at a workstation or for lower density applications. The line of Ethernet switches is used in both the central closet and at the end user station.

Marketing primarily consists of direct marketing using a sales force, tradeshows, trade magazine advertising, on-line advertising, web site, social media and public relations activities. Transition Networks also provides and participates in advertising and cooperative marketing campaigns with distribution partners.

The Company s Transition Networks and MILAN brand names are important to its business. The Company regularly supports these names by trade advertising and believes them to be well known in the marketplace.

Research and Development

Transition Networks continues to develop products that address the enterprise, service provider, security and industrial markets. This includes developing converters for emerging protocols and existing protocols in new markets, as well as new industry standards. Some of these products include remote management devices built on the IEEE® 802.3AH and 802.3AG standards, Metro Ethernet Forum (MEF)® standards and Power Over Ethernet based on the IEEE® 802.3AF standard. Some design efforts are paced by the development of critical components such as integrated circuits and optical transceivers.

Research and development consists primarily of testing, equipment and supplies associated with enhancing existing products and developing new products. Research and development costs are expensed when incurred and were $1,937,000 in 2011 compared to $1,966,000 in 2010.

Transition Networks research and development operations are conducted in the United States and China. Transition opened an office in China (Transition Networks China) in the third quarter of 2007. The China operation focuses primarily on engineering, including hardware and software development as well as testing. Additional China operations include marketing, purchasing, and sales support.

Competition

Transition Networks faces strong competition across its entire product line. A large number of competitors exist for the highest volume products in the Fast Ethernet and Gigabit Ethernet families as well as the Network Interface Devices (NIDs). Low cost competitors from China and Taiwan are strongest in Asian, Europe, Middle East, and African (EMEA) and South American markets, but have had limited success in the North American market for the media converter products. Transition Networks also faces new competitors as it enters new markets for industrial products, security market, and higher performance devices for the service provider market.

Order Book

Outstanding customer orders for Transition Networks products were approximately $4,418,000 at March 1, 2012 and $6,193,000 at March 1, 2011. Transition Networks orders are fulfilled on a relatively short-term basis and therefore the Company does not consider the order book as a significant indicator of longer term future results.

(iii) JDL Technologies, Inc.

JDL Technologies, Inc. (JDL), located in Fort Lauderdale, Florida, provides information technology (IT) solutions focused on network design and integration IT service management, network security, desktop virtualization, and managed network operation center services. JDL s 2011 sales were $12,401,000 (9% of consolidated sales) compared to 2010 sales of $12,712,000 (11% of consolidated sales). Project revenue totaled $11,310,000 in 2011 or 91% of JDL sales compared to $11,612,000 in 2010 or 91% of JDL sales. Managed services revenues were $1,091,000 and $1,100,000 in 2011 and 2010, respectively.

Products, Services and Solutions

With over 15 years of success in Florida, JDL s portfolio of technology solutions includes virtualization, managed services, wired and wireless network design and implementation services, and converged infrastructure configuration and deployment. With a team of highly skilled engineers, JDL develops best of class IT solutions that address the true pain points of its clients. JDL works with the newest and most advanced IT to implement effective business solutions specifically catered to each business needs.

JDL s expertise is in developing, deploying and maintaining solutions that enable and enhance IT landscapes specific to these core competencies:

Virtualization:
By leveraging industry knowledge and strategic partnerships such as Citrix, VMware and Microsoft, JDL s team of virtualization engineers assess, design, deploy, and manage a customized virtualization plan for clients ensuring access to any workload, anytime, anywhere, and on any device. An ideal virtualization environment designed by JDL can be comprised of just one, all, or a combination of server, desktop and application virtualization. As a result of JDL s tailored solutions, businesses benefit from reduced costs with increased performance, heightened workplace flexibility and agility, magnified adaptation to business change, and an upgraded level of security and disaster recovery protection.

Managed Services:
JDL s suite of managed services includes patch and asset management, automation, availability assurance, IT help desk, event alerting, remote and on-site support, endpoint security and desktop migration. JDL s implementation of managed services complements our clients current IT resources and personnel in businesses of all sizes and across all industries. Having JDL s engineers take on the daily management and availability assurance of a business infrastructure frees the current IT team to focus on the projects that are critical to the core business.

Network Services:
Having designed, deployed, and managed one of the largest wireless infrastructures in the country, JDL s team can advise businesses on the design and implementation of corporate networks from wired to wireless and beyond. Through partnerships with HP, Cisco Systems, Ruckus, Meru and others, JDL aligns with business needs to optimize its IT landscape.

Converged Infrastructure:
In recognizing that businesses grow and gain competitive advantage through the rapid adoption of IT innovation and responsiveness, JDL has built a converged infrastructure practice. By aligning with each business needs and helping overcoming IT obstacles, JDL s clients experience accelerated ROI and sustainability, reduced costs by combining infrastructure and enhanced security and disaster recovery.

Markets and Competition

Over the past 15 years, JDL Technologies has provided scalable and effective IT planning, implementation, and support services in K-12 education. Although having educational clients nationwide, its strongest base has been in Central and South Florida, a market that includes a number of other small and large IT value added resellers (VAR) and managed service providers (MSP). In order to differentiate itself from competitors, in 2010, JDL made a strategic decision to market position itself as a high-quality provider of design, implementation and management of information technology solutions enabling its clients to become more competitive in their business operations. This strategy has succeeded by using a vendor diagnostic approach while providing cost reduction, increased revenue generation, ease of use, greater availability and secure IT resources. With its repositioning, JDL also expanded its market focus from K-12 Education to include K-20 Education, Healthcare, Enterprise and Government markets.

Moving forward, JDL plans to continue working with clients to develop unique IT solutions that address specific business and IT requirements. As technology is constantly evolving with new solutions and methodologies, JDL s mission is to keep its growing portfolio of clients and their IT environments current with these changes. It is through JDL s relationship as a trusted advisor that its clients remain up to date with these technology changes and in turn rely on JDL to help determine if and when to adopt new technologies based on business goals. JDL Technologies believes in enabling business through technology.

Order Book

Outstanding customer orders and contracts for JDL products and services were approximately $750,000 at March 1, 2012 and $6,243,000 at March 1, 2011. The outstanding orders and contracts at March 1, 2011, reflected JDL s significant on-going contract with a South Florida school district that was completed in November 2011. Although JDL is pursuing a number of opportunities at the current time, it does not have current orders and contracts that are comparable to those in place in 2011. The Company does not consider current outstanding orders and contracts as a significant indicator of longer term future results.

(iv) Austin Taylor

Austin Taylor Communications, Ltd. is located in Bethesda, North Wales, U.K. Austin Taylor is a provider of telephony and data networking products to telecommunications companies, distributors and installers throughout the U.K., Europe and the Middle East. Austin Taylor sales were $3,288,000 (2% of consolidated revenues) in 2011 and $3,016,000 (3% of consolidated revenues) in 2010.

At its plant in Bethesda, the Company designs and manufactures external metal cabinets and internal metal boxes to industry standards and to customer specifications and procures other products from offshore sources. All manufacturing and supply line products are supported to ISO: 9001:2000 approved standards to guarantee customer quality, consistency and reliability. Approximately 59% and 62% of Austin Taylor sales were to U.K. customers in 2011 and 2010.

Outstanding customer orders for Austin Taylor products were approximately $158,000 at March 1, 2012 compared to $260,000 at March 1, 2011. Because Austin Taylor fills new orders on a relatively short timetable, the Company does not believe its order book is a significant indicator of longer term future results.

(2) Employment Levels

As of March 1, 2012 the Company employed 410 people. Of this number, 189 were employed by Suttle (including 79 in Hector, Minnesota and 110 in Costa Rica), 166 by Transition Networks, Inc. (137 in Minnetonka, MN, 20 in China, and 9 in the U.K.), 25 by JDL Technologies, Inc., 7 by Austin Taylor Communications, Ltd and 23 corporate general and administrative positions.

(3) Executive Officers of Registrant

The executive officers of the Company and their ages at March 1, 2012 are set forth below. See Item 9B of this Form 10-K for additional information on the Company s management.

Name	Age	Position[1]
William G. Schultz	43	President and Chief Executive Officer [2011][2]
David T. McGraw	60	Vice President, Treasurer and Chief Financial Officer [2008][3]
Bruce Blackwood	49	Vice President and General Manager, Suttle [2007][4]
Seweryn Sadura	41	Vice President and General Manager, Transition Networks [2011][5]
Michael J. Skucius	58	Vice President, Information Technology [2010][6]
Karen Nesburg Bleick	47	Vice President, Human Resources [2009][7]
Scott Fluegge	42	Vice President and General Manager, JDL Technologies, Inc [2011][8]
Kristin A. Hlavka	30	Corporate Controller [2011][9]

1 Dates in brackets indicate period during which officers began serving in such capacity. Executive officers serve at the pleasure of the Board of Directors and are elected annually for one-year terms.

2 Mr. Schultz was appointed Chief Executive Officer of the Company in May 2011. From May 2010 to May 2011 he served as the Company s Executive Vice President of Operations. From October 2007 to April 2010 he served as the Vice President and General Manager of Transition Networks, Inc. From May 2000 to September 2007, he served as Transition Networks Vice President of Marketing. Prior to May 2000, he was Distribution Business Manager for AMP Division of Tyco International, Ltd.

3 Mr. McGraw was appointed Chief Financial Officer in January 2008. From September 2002 to December 2007 he served as President of Suttle. From May 2001 to August 2002, he served as Chief Operating Officer of JDL Technologies, Inc. Prior to May 2001, he was Vice President-General Manager of Precision Diversified Industries in Plymouth, MN.

4 Mr. Blackwood was appointed Vice President and General Manager of Suttle in December 2007. From July 2001 to November 2007 he served as Suttle s Vice President of Sales. Prior to July 2001 he was Vice President of Sales for Americable.

5 Mr. Sadura was appointed Vice President and General Manager of Transition Networks in February 2011. From June 2007 to January 2011 he served as the Director of China Operations for Transition Networks. Prior to June 2007, he was a Product Manager at Transition Networks.

6 Mr. Skucius was appointed Vice President of Information Technology in January 2010. From July 2007 to December 2009 he served as Vice President and General Manager of JDL. From 1980 to 2007 he was the Company s Director of Management Information Services.

7 Ms. Nesburg Bleick was appointed Vice President, Human Resources in January 2009. From October 2002 to December 2008, she served as Director of Human Resources.

8 Mr. Fluegge was appointed Vice President and General Manager of JDL Technologies in December 2011. Prior to this, he was the Vice President of Workload Automation at GSS AMERICA / GSS INFOTECH / INFOSPECTRUM CONSULTING.

9 Ms. Hlavka was appointed Corporate Controller in May 2011. From July 2008 to April 2011, she served as the Assistant Corporate Controller. Prior to July 2008, she was an auditor for Deloitte and Touche, LLP.

(d) FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

Financial information about domestic and foreign operations and export sales may be obtained by reference to Note 11 of the Notes to Consolidated Financial Statements under Item 8 herein.

ITEM 1A. RISK FACTORS

Forward Looking Statements

Certain statements contained in this Annual Report on Form 10-K are forward-looking statements within the meaning of and in reliance on the Private Securities Litigation Reform Act of 1995, which provides a safe harbor for forward-looking statements. Actual events and results may differ materially from those expressed or forecasted in forward-looking statements due to a number of factors. The principal important risk factors that could cause our actual performance and future events and actions to differ materially from these forward-looking statements include, but are not limited to, the risk factors discussed below.

Risks Related to Our Business

The primary markets we serve are highly competitive, and our ability to compete requires continual focus on delivering high quality, competitively priced products and the regular introduction of new products that meet evolving customer requirements.

Competition in the markets for voice and data communications products is intense. Our ability to compete with other manufacturers of these products depends primarily on our engineering, manufacturing and marketing skills; the price, quality and reliability of our products; our delivery and service capabilities; and our control of operating expenses. We have experienced, and anticipate continuing to experience, pricing pressures from our customers as well as our competitors. The markets we serve are characterized by rapid technological advances and evolving industry standards. These markets can be significantly affected by new product introductions and marketing activities of industry participants. Certain of our competitors and potential competitors may have greater financial, technological, manufacturing, marketing, and personnel resources than we. Present and future competitors may be able to identify new markets and develop new products that are superior to those developed by us. They may also adapt new technologies faster, devote greater resources to research and development, promote products more aggressively, and price products more competitively than us. We cannot ensure that competition will not intensify or that we will be able to compete effectively in the markets in which we compete.

We face many challenges in maintaining acceptable margins, and our level of gross margin may not be sustainable.

Gross margins among our products vary and are subject to fluctuation from quarter to quarter. The factors that may impact our gross margins adversely are numerous and include:

- Changes in customer, geographic, or product mix;
- Our ability to reduce product costs;
- Increases in material or labor costs;
- Expediting costs incurred to meet customer delivery requirements;
- Excess inventory and inventory carrying charges;
- Obsolescence charges;
- Changes in shipment volume;
- Changes in component pricing;
- Increased price competition;
- Changes in distribution channels;
- Increased warranty cost; and
- Our ability to manage the impact of foreign currency exchange rate fluctuations.

Consolidation among our customers has occurred and further consolidation may occur and result in the loss of some customers and may reduce revenue during the pendency of business combinations and related integration activities.

We believe future consolidation may occur among our customers in order for them to increase market share and achieve greater economies of scale. Consolidation has affected our business as our customers focus on completing business combinations and integrating their operations. In certain instances, customers integrating large-scale acquisitions have reduced their purchases of our products during the integration period.

The business impact to us of significant customer mergers is likely to be unclear until sometime after these transactions are completed. After a consolidation occurs, a customer may choose to reduce the number of vendors from which it purchases equipment and may choose one of our competitors as its preferred vendor. We cannot ensure that we will continue to supply equipment to the surviving communications service provider after a business combination is completed.

Our profitability could be affected negatively if one or more of our key customers substantially reduces orders for our products or transitions their purchases towards lower gross margin products.

Our customer base is somewhat concentrated, with our top ten customers accounting for 76%, 70% and 72% of net sales for fiscal 2011, 2010 and 2009, respectively. One of our largest customers, Verizon, accounted for 6%, 6% and 9% of our net sales for the fiscal years 2011, 2010 and 2009. The merger of AT&T and BellSouth in our fiscal 2007 created another large customer for us. In fiscal 2011, 2010 and 2009, this combined company accounted for approximately 9%, 9% and 12% of our sales, respectively. If we lose a significant customer for any reason, our sales and gross profit will be negatively affected.

Our record 2011 sales and profitability resulted in part from sales to one customer. We do not have any long-term commitment from this customer and do not expect 2012 sales from that customer to exceed 5% of our overall revenues.

Our 2011 sales included $32.8 million, or 22.8% of our overall revenue, from a one-time large network upgrade project with a Fortune 500 company that we completed in 2011. Although we expect to continue to sell to this customer in the future, we do not expect ongoing orders in 2012 or future years to exceed five percent of our revenues. If we unable to replace this business, it may have an adverse effect on our overall 2012 revenue and profitability.

Our JDL Technologies, Inc. segment has recently been dependent on a single customer. Although JDL s business plan is focused on providing a range of products and services to a broad range of customers in the education, healthcare, enterprise and government markets, we cannot ensure that JDL will be successful in its efforts.

Substantially all the sales of the Company s IT services business unit JDL Technologies, Inc. in 2011 and 2010 were to a single South Florida school district and accounted for 8.1% and 10.3% respectively of overall Company revenues. Although JDL began in 2011 to market a broad range of products and services to a number of potential customers, we cannot ensure that JDL will be able to achieve significant revenue in 2012 from either this customer or from new customers. If JDL is unable to achieve significant revenues, it may have an adverse effect on our overall 2012 revenue and profitability.

Our market is subject to rapid technological change and, to compete effectively, we must continually introduce new products that achieve market acceptance.

The communications equipment industry is characterized by rapid technological changes, evolving industry standards, changing market conditions, short product life cycles and rapidly changing customer requirements and frequent new product and service introductions and enhancements. The introduction of products using new technologies or the adoption of new industry standards can make our existing products, or products under development, obsolete or unmarketable. Our future success will depend on our ability to enhance our existing products, to introduce new products to meet changing customer requirements and emerging technologies, and to demonstrate the performance advantages and cost-effectiveness of our products over competing products. Failure by us to modify our products to support new alternative technologies or failure to achieve widespread customer acceptance of these modified products could cause us to lose market share and cause our revenues to decline.

We may not predict technological trends or the success of new products in the communications equipment market accurately. New product development often requires forecasting of market trends, development and implementation of new technologies and processes and substantial capital commitments. We do not know whether other new products we develop will gain market acceptance or result in profitable sales.

Certain of our competitors have greater engineering and product development resources than we have. Although we expect to continue to invest significant resources in product development activities, our efforts to achieve and maintain profitability will require us to be selective and focused with our research and development expenditures. If we fail to anticipate or respond in a cost-effective and timely manner to technological developments, changes in industry standards or customer requirements, or if we experience any significant delays in product development or introduction, our business, operating results and financial condition could be affected adversely.

We may experience delays in developing and marketing product enhancements or new products that respond to technological change, evolving industry standards and changing customer requirements. There can be no assurance that we will not experience difficulties that could delay or prevent the successful development, introduction, and marketing of these products or product enhancements, or that our new products and product enhancements will adequately meet the requirements of the marketplace and achieve any significant or sustainable degree of market acceptance in existing or additional markets. In addition, the future introductions or announcements of products by us or one of our competitors embodying new technologies or changes in industry standards or customer requirements could render our then-existing products obsolete or unmarketable. We cannot ensure that the introduction or announcement of new product offerings by us or one or more of our competitors will not cause customers to defer their purchase of our existing products, which could cause our revenues to decline.

We evaluate and frequently pursue acquisitions, but we may not successfully close these acquisitions and, if these acquisitions are completed, we may have difficulty integrating the acquired businesses with our existing operations.

We regularly consider the acquisition of complementary companies and product lines. We cannot, however, ensure that we will be able to find appropriate candidates for acquisitions, reach agreement to acquire them, or obtain requisite shareholder or regulatory approvals needed to close strategic acquisitions, despite the effort and management attention invested.

The impact of future acquisitions on our business, operating results and financial condition is uncertain. In the case of businesses we may acquire in the future, we may have difficulty assimilating these businesses and their products, services, technologies and personnel into our operations. These difficulties could disrupt our ongoing business, distract our management and workforce, increase our expenses and materially adversely affect our operating results and financial condition. Also, we may not be able to retain key management and other critical employees after an acquisition. We may also acquire unanticipated liabilities. In addition to these risks, we may not realize all of the anticipated benefits of these acquisitions.

Our operating results fluctuate from quarter to quarter.

Our operating results are difficult to predict and may fluctuate significantly from quarter to quarter. Fluctuations in our quarterly operating results may be caused by many factors, including the following:

- the volume of customer orders and our ability to fulfill those orders in a timely manner;
- the overall level of capital expenditures by our customers;
- work stoppages and other developments affecting the operations of our customers;
- the timing of and our ability to obtain new customer contracts;
- the timing of revenue recognition;
- the timing of new product and service introductions;
- the availability of products and services;
- market acceptance of new and enhanced versions of our products and services;
- variations in the mix of products and services we sell;
- the location and utilization of our production capacity and employees; and
- the availability and cost of key components of our products.

Our expense levels are based in part on expectations of future revenues. If revenue levels in a particular quarter are lower than expected, our operating results will be affected adversely.

We depend on manufacturing relationships and on limited-source suppliers and any disruptions in these relationships may cause damage to our customer relationships.

We procure all parts and certain services involved in the production of our products from, and subcontract much of our product manufacturing, to outside firms that specialize in these services. Although most of the components of our products are available from multiple vendors, we have several single-source supplier relationships, either because alternative sources are not available or because the relationship is advantageous to us. We cannot ensure that our suppliers will be able to meet our future requirements for products and components in a timely fashion. In addition, the availability of many of these components to us is dependent in part on our ability to provide our suppliers with accurate forecasts of our future requirements. Delays or lost sales could be caused by other factors beyond our control, including defects in the quality of components or products supplied by others.

We are dependent upon our senior management and other critical employees.

Like all communications technology companies, our success is dependent on the efforts and abilities of our senior management personnel and other critical employees, including those in sales, marketing and product development functions. Our ability to attract, retain and motivate these employees is critical to our success. In addition, because we may acquire one or more businesses in the future, our success will depend, in part, upon our ability to retain and integrate our own personnel with personnel from acquired entities that are necessary to the continued success or the successful integration of the acquired businesses.

Managing our inventory is complex and may include write-downs of excess or obsolete inventory.

Managing our inventory of components and finished products is complicated by a number of factors, including the need to maintain a significant inventory of finished goods for orders we anticipate but may not be received. These issues may cause us to purchase and maintain significant amounts of inventory. If this inventory is not used as expected based on anticipated requirements, it may become excess or obsolete. The existence of excess or obsolete inventory can result in sales price reductions or inventory write-downs, which could adversely affect our business and results of operations.

We face risks associated with expanding our sales outside of the United States.

We believe that our future growth depends in part upon our ability to increase sales in international markets. These sales are subject to a variety of risks, including fluctuations in currency exchange rates, tariffs, import restrictions and other trade barriers, unexpected changes in regulatory requirements, longer accounts receivable payment cycles and potentially adverse tax consequences, and export license requirements. In addition, we are subject to the risks inherent in conducting business internationally, including political and economic instability and unexpected changes in diplomatic and trade relationships. We cannot ensure that one or more of these factors will not have a material adverse effect on our business strategy and financial condition.

Compliance with internal control requirements is expensive and poses certain risks.

We expect to incur significant continuing costs, including accounting fees and staffing costs, in order to maintain compliance with the internal control requirements of the Sarbanes-Oxley Act of 2002. Expansion of our business, particularly internationally, will necessitate ongoing changes to our internal control systems, processes and information systems. In addition, if we complete acquisitions in the future, our ability to integrate operations of the acquired company could impact our compliance with Section 404 of the Sarbanes-Oxley Act. We cannot be certain that as our business changes, our current design for internal control over financial reporting will be sufficient to enable management to determine that our internal controls are effective for any period, or on an ongoing basis.

In the future, if we fail to complete the annual Section 404 evaluation in a timely manner, we could be subject to regulatory scrutiny and a loss of public confidence in our internal controls. In addition, any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations.

Product defects or the failure of our products to meet specifications could cause us to lose customers and revenue or to incur unexpected expenses.

If our products do not meet our customers performance requirements, our customer relationships may suffer. Also, our products may contain defects or fail to meet product specifications. Any failure or poor performance of our products could result in:

- delayed market acceptance of our products;
- delayed product shipments;
- unexpected expenses and diversion of resources to replace defective products or identify and correct the source of errors;
- damage to our reputation and our customer relationships;
- delayed recognition of sales or reduced sales; and

product liability claims or other claims for damages that may be caused by any product defects or performance failures.

Our sales and operations may continue to be impacted adversely by current global economic conditions.

For the past several years, financial markets globally have experienced extreme disruption. This includes, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, ratings downgrades of certain investments and declining valuations of others. The severity and length of the present disruptions in the financial markets and the global economy are unknown. We cannot ensure that there will not be a further deterioration in financial markets and in business conditions generally. These economic developments have adversely affected our business in a number of ways and will likely continue to adversely affect our business during the foreseeable future.

Risks Related to Our Common Stock

Our stock price has been volatile historically and the price of our common stock may fluctuate significantly in the future.

The trading price of our common stock has been and may continue to be subject to wide fluctuations. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products by us or our competitors, the operating and stock price performance of other companies that investors may deem comparable to us, and new reports relating to trends in our markets or general economic conditions.

In addition, the stock market in general, and prices for companies in our industry in particular, have experienced extreme volatility that often has been unrelated to the operating performance of these companies. These broad market and industry fluctuations may adversely affect the price of our common stock, regardless of our operating performance.

Anti-takeover provisions in our charter documents, our shareholder rights agreement and Minnesota law could prevent or delay a change in control of our company.

Provisions of our articles of incorporation and bylaws, our shareholder rights agreement (also known as a poison pill) and Minnesota law may discourage, delay or prevent a merger or acquisition that a shareholder may consider favorable, and could limit the price that investors are willing to pay for our common stock. These provisions include the following:

- advance notice requirements for shareholder proposals;
- authorization for our board of directors to issue preferred stock without shareholder approval;
- authorization for our board of directors to issue preferred stock purchase rights upon a third party s acquisition of 16.5% or more of our outstanding shares of common stock;
- limitations on business combinations with interested shareholders;
- classification of Board of Directors that serve staggered, three year terms; and
- a super majority vote by shareholders is required to approve certain corporate actions, including merger transactions.

Some of these provisions may discourage a future acquisition of our company even though our shareholders would receive an attractive value for their shares, or a significant number of our shareholders believe such a proposed transaction would be in their best interest.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

CSI conducts administrative, manufacturing and engineering functions at the following facilities:

- In Minnetonka, Minnesota the Company owns a 105,000 square foot building where its executive and administrative offices are located. In addition, Transition Networks uses this facility for its warehouse, assembly, engineering and administrative operations, JDL Technologies, Inc. uses this facility for some administrative operations, and Suttle uses this facility for its sales, marketing and product development.
- Suttle s manufacturing is conducted at two locations. At Hector, Minnesota, the Company owns three plants totaling 88,000 square feet of manufacturing space. The Company leases 40,000 square feet of manufacturing space in San Jose, Costa Rica.
- Austin Taylor Communications, Ltd. owns a 40,000 square foot facility in Bethesda, Wales, U.K.
- Transition Networks leases 10,000 square feet of office space for engineering, procurement and marketing activities in Shanghai, China. The Company also leases 7,000 square feet of office space in the U.K. for its Patapsco operations.

CSI believes these facilities will be adequate to accommodate its administrative, manufacturing and distribution needs for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

The Company is subject to claims and lawsuits that have been filed in the ordinary course of business. From time to time, the Company brings suit against others to enforce contract rights or property rights, or to collect debts in the ordinary course of business. Management believes that the resolution or settlement of currently pending litigation will not have a material adverse effect on the results of operations or liquidity of the Company.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASE OF EQUITY SECURITIES

(a) MARKET INFORMATION

The Company s common stock trades on the NASDAQ under the trading symbol JCS.

The table below presents the price range of high and low trades of the Company s common stock for each quarterly period indicated as reported by NASDAQ for 2011 and 2010.

	2011		2010	
	High	**Low**	**High**	**Low**
First	$ 16.49	$ 13.33	$ 13.60	$ 11.27
Second	20.82	15.01	13.31	10.15
Third	20.93	12.60	11.57	10.00
Fourth	17.19	12.50	14.82	11.02

(b) HOLDERS

At March 1, 2012 there were approximately 579 registered holders of record of Communications Systems, Inc. common stock.

(c) DIVIDENDS

Communications Systems, Inc. paid regular quarterly dividends to its shareholders on the dates and at the rates indicated below:

Payment Date	Dividend per Share
January 1, 2012	$ .15
October 1, 2011	.15
July 1, 2011	.15
April 1, 2011	.15
January 1, 2011	.15
October 1, 2010	.15
July 1, 2010	.15
April 1, 2010	.14
January 1, 2010	.14

The payment of future dividends will be determined at the discretion of the Board of Directors.

(d) INFORMATION REGARDING EQUITY COMPENSATION PLANS

The following table presents information about the Company s equity compensation plans, under which equity securities of the Company are authorized for issuance, as of December 31, 2011:

Securities Authorized for Issuance Under Equity Compensation Plans

Plan Category (1)	Number of shares of common stock to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options warrants and rights	Number of shares of common stock remaining available for future issuance under equity compensation plans (excluding shares in column (a))
Equity compensation plans approved by security holders:			
1992 Stock Plan-Employee Plan	162,243	$ 14.60	
1992 Stock Plan-Nonemployee Director Plan	147,000	$ 9.63	
1990 Employee Stock Purchase Plan	3,241	$ 12.65	66,413
2011 Executive Incentive Compensation Plan	15,582	$ 17.97	984,418
Equity compensation plans not approved by security holders:			
None			

(1) The Company does not have individual compensation arrangements involving the grant of options, warrants and rights.

(e) FIVE YEAR PERFORMANCE GRAPH

The following graph presents, at the end of each of the Company s last five fiscal years, the cumulative total return on the common stock of the Company as compared to the cumulative total return reported for the NASDAQ (U.S.), and the NASDAQ Telecommunications Index. Company information and each index assume the investment of $100 on the last business day before January 1, 2006 and the reinvestment of all dividends.

Comparison of Five-Year Cumulative Total Return

Company or Index	2006	2007	2008	2009	2010	2011
Communications Systems, Inc.	$ 100.000	$ 120.127	$ 83.889	$ 141.012		