COMMUNICATIONS SYSTEMS INC
Form 10-K
March 14, 2014

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, 2013

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 **Preferred Stock Purchase Rights**	**NASDAQ**

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. o

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 $74,909,000 based upon the closing sale price of the Company s common stock on the NASDAQ on June 30, 2013.

As of March 1, 2014 there were outstanding 8,556,473 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 June 4, 2014 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 business unit 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 conversion products, Ethernet switches, and other connectivity and data transmission products. 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 three 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; and *JDL Technologies*, 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 these 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 12 of the Notes to Consolidated Financial Statements under Item 8.

(c) NARRATIVE DESCRIPTION OF BUSINESS

(1) Information Regarding Business Segments

(i) Suttle

Suttle manufactures and markets a variety of telecommunication products for outside plant and premise distribution under the Suttle brand name in the United States and internationally. Suttle s new FutureLink brand includes solutions for higher speeds, toolless connectivity and lower cost of ownership, such as copper and fiber connectivity systems, scalable terminals and enclosures, network interface devices (NIDs), splitters, and active technologies for voice, data and video communications. Suttle also manufactures and markets a line of residential structured wiring products under the SOHO (Small Office, Home Office) Access brand name, and passive premise distribution, such as xDSL filters, under the SpeedStar brand. Suttle manufactures 66% of its products at its plants in Hector, Minnesota (Suttle Apparatus Minnesota Division) and San Jose, Costa Rica (Suttle Costa Rica, S.A.). The other 34% are purchased from offshore contract manufacturers. Segment sales were $54,346,000 (41% of consolidated revenues) in 2013 and $45,030,000 (43% of consolidated revenues) in 2012.

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.

Suttle is expanding operational capabilities within its U.S. manufacturing to maximize flexibility and improve speed to market capacity. We are committed to maintaining both internal and external quality standards as well as industry product specifications. The company s quality management systems are ISO 9001 and TL9001 certified. Additionally, Suttle was one of the first companies to pass the new Telcordia GR-3167 standard for energizing very high-rate digital subscriber lines (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 enables us to continue to develop new innovative product solutions.

Outside Plant:

Suttle s outside plant products (OSP) are designed to operate in challenging environments yet be easily accessible, extend the life of the existing network, enhance data speeds, and prevent loss.

Suttle OSP systems are designed for flexibility and scalability in real world applications for both copper and fiber networks. Suttle s FutureLink OSP Fiber solutions offer a range of products including terminals, patch and splice and splitter enclosures. For copper networks, Suttle s FutureLink OSP Copper solutions include building entrance terminal and enclosures.

Premise Distribution:

Suttle provides service distribution products for cost-effective solutions using existing wiring. These products reduce installation time and labor costs, and increase the provider s return on investment. In addition to reducing a service provider s up-front costs, Suttle s high throughput solutions help eliminate potential bottlenecks to future-proof the installation, reducing future costs.

Our FutureLink fiber solutions help providers deploy fiber-to-the-premise (FTTP) service. These products feature higher speed connections, tool-less connectivity and lower cost of ownership. Our popular SOHO Access enclosures and modules provide flexibility and versatility for the termination and management of voice, data, and video connections.

Active solutions distribute service inside the premise through electronic devices. Suttle s active service solutions allow the distribution of service at higher speeds regardless of media, using technologies under FutureLink brand products. Passive solutions provide traditional telephony and broadband technology deployments. Through our highly recognized brands SpeedStar and Corroshield® as well as our new brand for higher speeds FutureLink Suttle provides the right solution for wired distribution.

Markets and Marketing

Suttle markets its outside plant and premise distribution products globally to telecommunications companies. Suttle has a solid history of offering long-term solutions to some of the largest global providers, by understanding the customer s needs and providing innovative solutions coupled with strong customer support. Suttle also 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 media including trade shows, associations, advertising, social media and the Suttle website, www.suttleonline.com.

Customers

Suttle s customers include the major telecommunication carriers globally, including Verizon, ATT, and CenturyLink (formerly Qwest). Major telephone companies are served directly by Suttle s sales staff and through a select group of distributors. Sales (including DSL) to the major telephone companies, as a group, both directly and through distribution, represented 80% of Suttle s sales in 2013 and 75% in 2012.

Other customers include smaller telephone companies, electrical/low-voltage contractors, home builders, and a nationwide network of distributors. Suttle serves these customers primarily through distributors but also directly by its 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 11% of Suttle s sales in 2013 and 12% in 2012. Sales to international customers and other customers represented 9% of Suttle s sales in 2013 and 13% in 2012.

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, 2014 were approximately $2,008,000 compared to approximately $2,961,000 at March 1, 2013. 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 manufactures its products 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 Tyco Electronics Connectivity. Although Suttle has not generally experienced significant problems in obtaining its required supplies, periodically 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.

Intellectual Property

The Suttle brand name is a trademark important to its business. Suttle regularly supports this name by trade advertising and believes it is well known in the marketplace. Other important trademarks include FutureLink for end-to-end products for outside plant, connectivity and premise distribution; SOHO Access for small office and home office enclosures and modules; SpeedStar for passive premise connectivity; and CorroShield® brand gel that prevents network corrosion.

(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 sells NIDs, media converter devices, 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). Transition sells its products through distributors, resellers, integrators, OEMs, and directly to service providers. 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 $43,857,000 (33% of consolidated sales) in 2013 compared to $53,843,000 (52% of consolidated sales) in 2012. International sales accounted for 30% of Transition s sales, or $13,196,000 in 2013, compared to $14,457,000, or 27% of Transition s sales in 2012.

Products

Transition Networks designs, assembles and markets 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. 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: 10 Gigabit Ethernet, Gigabit Ethernet, Fast Ethernet, Ethernet, T1/E1, DS3, Circuit Emulation Services (TDM or ISDN over IP), RS232, RS485, OC3, OC12, and more. Transition Networks develops product hardware and software internally, and expenses the related costs as they are incurred. The company also buys and resells products from other OEMs to augment our product offerings. In connection with the sale of its hardware products, Transition Networks provides its customers with a variety of software management options including powerful Element Management System (EMS) software for providing superior service provisioning and monitoring of next-generation Carrier Ethernet 2.0 Services. The Company has been developing and marketing Ethernet-based networking products for approximately 25 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 uses contract manufacturers to manufacture its products in different geographical locations. In 2013, 66% of the total value of its products was manufactured in Asia while the remaining 34% was manufactured in the US. Offshore sources of supply are subject to certain risks, including political risk. The Company has alternate sources of supply for its products in different geographical locations 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 federal government, enterprise networks, service providers networks, security and surveillance, as well as industrial environments. 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 last mile access, backhaul, central closet and at the end user stations. The NID line of products address the high quality access requirements for both business services and wireless backhaul data communications and telecommunications applications.

Marketing primarily consists of direct marketing using a sales force, tradeshows, trade magazine advertising, on-line advertising, website, 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 federal government, 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, 802.3AG, ITU-T Y.1731 standards, Metro Ethernet Forum (MEF)® and MEF 2.0 standards, and Power Over Ethernet based on the IEEE® 802.3AF and IEEE® 802.3AT standards. Some design efforts are paced by the development of critical components such as integrated circuits and optical transceivers.

Research and development consists of conception, design and development of new products, as well as testing, and equipment and supplies associated with enhancing existing products. Research and development costs are expensed when incurred and were $2,277,000 in 2013 compared to $2,030,000 in 2012.

Transition Networks research and development operations are conducted in the United States, United Kingdom and China. The US location has a global engineering and product development leadership responsibility. 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. In the 2013 fourth quarter, the Company decided to close its Chinese engineering facility and received regulatory approval from the Chinese government to commence deregistration procedures, the first step in closing this facility. The Company decided to close the China operations to streamline engineering processes and to mitigate the rising costs of doing business in Shanghai. The Company expects to complete the office closing in the first half of 2014. The UK facility was added in 2011 as a result of the Patapsco acquisition. The UK location focuses on engineering and support for Circuit Emulation Products as well as logistics and sales activities.

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 NIDs. Low cost competitors from China and Taiwan are strongest in Asian, Europe, Middle East, and Africa (EMEA) and South American markets, but have had less success in the North American media converter product market. 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 $2,389,000 at March 1, 2014 and $2,651,000 at March 1, 2013. 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 Technologies or JDL), based in Fort Lauderdale, Florida, provides information technology (IT) solutions focused on network design and integration, IT service and support management, cloud and virtualization services, and network operations center management. JDL s 2013 sales were $33,116,000 (25% of consolidated sales) compared to 2012 sales of $5,377,000 (5% of consolidated sales). Project revenue totaled $31,698,000 in 2013 or 96% of JDL sales compared to $4,123,000 in 2012 or 77% of JDL sales. Managed services revenues were $1,418,000 and $1,254,000 in 2013 and 2012, respectively.

Competitive Strategy

While the South Florida information technology market includes a number of other value-added resellers (VARs) and managed service providers (MSPs), JDL has differentiated itself in several strategic ways during more than 15 years of success and is uniquely qualified to help organizations optimize their information technology.

§ JDL has never wavered in its commitment to help IT professionals keep their technology up and running, fix problems quickly, support their user communities, and regularly add new value to their organizations. Key avenues for delivering on this commitment and key competitive advantages are JDL s secure, on-premise, state-of-the-art data center and managed services operations center.

§ JDL s portfolio of technology solutions has steadily expanded to reflect the constant introduction of new technologies as well as growing demand among businesses for increasingly diverse solutions to strengthen their competitive edge and continuity. With its team of professionally certified engineers, more than 240 years of technical experience, and talented leadership, JDL develops best-of-breed IT solutions that effectively meet these demands.

§ Augmenting its own exceptional bench strength, JDL maintains active partnerships with industry leaders such as Cisco, Citrix, EMC, HP, Sophos and VMware as well as younger technology innovators like Aerohive, Axcient, Bradford Networks, Meru and Nutanix. These strategic partnerships enable JDL to leverage a comprehensive array of proven technologies in order to design solutions uniquely suited to each client.

As a result of these combined factors, JDL has become a trusted advisor to a wide range of clients throughout South Florida, and continues to earn important incremental business and solid references.

This solid foundation has allowed JDL to expand into Central Florida, opening an office in 2013 to serve clients throughout the Tampa and Orlando region, led by a seasoned sales manager well-known in the area for his technology experience and contact network. This expansion taps an under-served market that JDL is well-positioned to penetrate.

Targeted Vertical Markets

Looking beyond its deep roots in the public education sector, in 2012 JDL began to aggressively expand into select other verticals, including the healthcare market and general commercial enterprise.

Education:
Prior to 2013, JDL s largest client for the past several years had been the School Board of Broward County, Florida (SBBC), the sixth largest system in the United States. JDL staffs and manages the SBBC network operations center, which monitors all network elements (servers, switches, routers) and more than 60,000 computers in 265 buildings.

Leveraging this experience, in October 2012, JDL was selected to provide the hardware and wiring for 232 schools in the Miami-Dade County Public School District (M-DCPS) as part of the wireless classroom initiative. Miami-Dade is the fourth-largest district in the U.S., serving some 345,000 students and employing more than 40,000 educators and staff. Additionally, in the first quarter of 2013, JDL successfully bid for the networking project that will enable wireless classrooms in the De Soto County Public School District, JDL s first win in the Central Florida region.

Healthcare:
In its strategic advance on the healthcare vertical, during the fourth quarter of 2012 JDL sought and won status as a preferred technology vendor for two of Florida s four Regional Extension Centers (RECs), federally funded by the Health Information Technology REC Grant Program to improve healthcare delivery by promoting the widespread adoption and meaningful use of health information technology. Through these RECs, JDL has access to healthcare practices in 17 counties throughout Central Florida. In response to one of their members most immediate needs for a simple, managed data protection solution that meets HIPAA compliance standards JDL is deploying an enterprise-grade encryption solution that has been reengineered to extend cost-effective data protection to the numerous midsize and smaller providers in the region.

In South Florida, JDL maintains several healthcare-related clients and continues to grow this base, which includes a leading producer of diabetes management solutions used around the world, a multi-location practice specializing in diabetes and other endocrine-related disorders, innovative emergency care centers, and a large pharmacy chain.

Commercial:
Among commercial enterprises, JDL continues to build a solid roster of diverse clients, including:

- A 60-year-old Florida financial institution with two dozen branches and more than $4 billion in assets;
- A global fitness program whose 14 million followers take weekly classes in over 100,000 locations; and
- A well-known furniture store in Florida since the 1960s with more than a dozen showrooms and warehouses.

Technology Solutions

JDL Technologies specializes in designing, deploying and managing information technology solutions that enable organizations to focus on the mission-critical activities that drive their success. JDL s IT solutions encompass an extensive range of networking, virtualization, cloud and other services many of which are available under ongoing JDL management in order to conserve client IT resources and generate monthly recurring revenues for the company.

Managed Services:
JDL s flagship brand, JDL TechWatch Managed IT Services, continues to expand, and currently offers network management, availability assurance, event alerting and incident management; server, workstation, mobile device and other asset management; software patching services; IT help desk support; SIP trunking; migration, conversion and vendor management. JDL also offers technical consulting services and training.

Network Services:
The JDL team has extensive experience in assessing, designing and implementing wired and wireless networks as well as entire IT infrastructures. Networking services also include MPLS, private line and IP, network and endpoint security, network tuning and cabling/wiring services.

Cloud Solutions:
JDL s cloud services range from storage, backup and recovery to hosted PBX, hosted contact center services and hosted email services, all billable as monthly recurring revenue. Many clients are opting to move elements of their infrastructures to the cloud for the benefits of vertical and horizontal scalability and internal bandwidth conservation.

Virtualization:
JDL s talented virtualization engineers assess, design, deploy, and manage virtualization programs that ensure client access to any workload, anytime, anywhere, on any device. Virtualization may encompass desktops, servers, applications, storage or any combination, including connectivity and software licensing. Businesses gain the advantage of economies of scale and enhanced security and disaster recovery protections that are inherent in virtualized environments.
As information technology continues to evolve at the speed of light, JDL is committed to retaining its position on the leading edge by ensuring its engineers are trained and certified in the newest technology solutions.

Order Book and Future Plans

Outstanding customer orders and contracts for JDL products and services were approximately $1,501,000 at March 1, 2014 and $24,491,000 at March 1, 2013. The outstanding orders and contracts at March 1, 2014 are primarily projects with the Broward County School District and are scheduled to complete by June of 2014. The Company does not consider current outstanding orders and contracts as a significant indicator of longer-term future results.

Most of JDL s revenues in 2013 and earlier years have been derived from projects to supply IT infrastructure and services for K-12 schools that were funded by federal and local government sources. Because this form of funding varies substantially from year to year, there have been large swings in JDL s annual revenues over the past several years. We expect this volatility in JDL s annual revenues to continue in 2014 and future years. Accordingly, in order to reduce its dependence on government funding, JDL continues to aggressively pursue opportunities to provide managed services, migration to the cloud, virtualization and other network services for small and medium sized commercial businesses with a focus on healthcare, legal and financial services markets.

(2) Employment Levels

As of March 1, 2014 the Company employed 596 people. Of this number, 420 were employed by Suttle (including 106 in Hector, Minnesota, 312 in Costa Rica and 2 in the U.K.), 128 by Transition Networks, Inc. (111 in Minnetonka, MN, 8 in China, and 9 in the U.K.), 30 by JDL Technologies, Inc., and 18 in corporate general and administrative positions.

(3) Executive Officers of Registrant

The executive officers of the Company and their ages at March 1, 2014 are set forth below. See Item 9B of this Form 10-K for additional information on the Company s management.

Name	Age	Position[1]
Curtis A. Sampson	80	Chairman of the Board and Interim Chief Executive Officer [2013][2]
Edwin C. Freeman	58	Vice President, Treasurer and Chief Financial Officer [2013][3]
Bruce Blackwood	51	President and General Manager, Suttle [2007][4]
Scott Otis	52	President and General Manager, Transition Networks [2013][5]
Michael J. Skucius	60	Vice President, Information Technology [2010][6]
Scott Fluegge	44	President and General Manager, JDL Technologies, Inc [2011][8]
Kristin A. Hlavka	32	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 subject to contractual agreements.

2 Mr. Sampson was appointed Interim Chief Executive Officer of the Company in September 2013. He served as the Company s Chief Executive Officer from 1969 to June 2007. He has been the Company s Chairman of the Board of Directors since 1971.

3 Mr. Freeman was appointed Chief Financial Officer in September 2013. From March 1992 to September 2013, he held management positions within operations and finance at Bro-Tex Co, Inc, (paper and cloth wiper products, and carpet recycling) most recently serving as the Vice President and Chief Financial Officer. Prior to his appointment as Chief Financial Officer, he served as a director of CSI since 1988.

4 Mr. Blackwood served as Vice President and General Manager of Suttle from December 2007 until he was appointed President in September 2013. 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. Otis was appointed President and General Manager of Transition Networks in September 2013. From December 2010 to June 2011 he served as Vice President, Operations - Professional Services for TE Connectivity, Inc. Prior to December 2010, he was the Vice President, Marketing and Business Development ADC Professional Services.

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 Mr. Fluegge served as Vice President and General Manager of JDL Technologies from December 2011 until he was appointed President in September 2013. Prior to this, he was the Vice President of Workload Automation at GSS AMERICA / GSS INFOTECH / INFOSPECTRUM CONSULTING.

8 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. She also served as Interim Chief Financial Officer from May 2013 until September 2013.

(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 12 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. Some of our competitors and potential competitors 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 affect 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;
- Lower margins on competitive-bid contracts;
- 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, resulting in the loss of some customers and reducing revenue during the pendency of business combinations and related integration activities.

We believe future consolidation may occur among our customers 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 83%, 76% and 76% of net sales for 2013, 2012 and 2011, respectively. The merger of AT&T and BellSouth in our fiscal 2007 created one of our largest customers. In fiscal 2013, 2012 and 2011, this combined company accounted for approximately 24%, 17% and 9% of our sales, respectively. Another one of our largest customers, Verizon, accounted for 8%, 8% and 6% of our net sales for the years 2013, 2012 and 2011. If we lose a significant customer for any reason, our sales and gross profit will be negatively affected.

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. Our failure 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. We cannot ensure 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.

Our business units are dependent upon federal government spending.

Our JDL Technologies and Transition Networks business units are involved in projects that receive much of their funding from the United States federal government. To the extent that federal government spending is delayed or curtailed by government actions, our revenues and operating results may be adversely affected.

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 timing of federal and state government funding of projects;
- 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.

Part of our future success depends on our ability to successfully transition all of our operations to our new Enterprise Resources Planning system.

During 2011 and 2012, we purchased and began to install a new Enterprise Resource Planning (ERP) system. On April 4, 2013, our Transition Networks business unit went live on this system. The new ERP system is designed to significantly strengthen our long-term term performance by standardizing all CSI business units on a common platform, lowering our manufacturing costs, and better managing our supply chain. We expect Suttle to go live on the new ERP sometime in 2014. If we are unable to successfully transition our remaining business units to the ERP in our proposed timetable, we will experience a delay in achieving improved operating efficiencies as well as additional costs related to a delayed implementation.

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:

- The Company owns a 105,000 square foot building in Minnetonka, Minnesota, 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. The Company owns three plants totaling 88,000 square feet of manufacturing space in Hector, Minnesota. 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 2013 and 2012.

	2013		2012	
	High	Low	High	Low
First	$ 11.25	$ 9.75	$ 15.49	$ 12.91
Second	10.69	9.55	14.09	10.36
Third	12.35	9.66	11.87	9.96
Fourth	12.25	9.95	11.52	9.73

(b) HOLDERS

At March 1, 2014 there were approximately 577 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, 2014	$ .16
October 1, 2013	.16
July 1, 2013	.16
April 1, 2013	.16
December 27, 2012	.16
October 1, 2012	.16
July 1, 2012	.16
April 1, 2012	.16
January 1, 2012	.15

The Company accelerated the payment of the dividend declared in the fourth quarter of 2012 and paid the dividend on December 27, 2012 rather than January 1, 2013. 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, 2013:

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	84,718	$ 14.29	
1992 Stock Plan-Nonemployee Director Plan	117,000	$ 10.24	
1990 Employee Stock Purchase Plan	3,153	$ 10.03	35,587
2011 Executive Incentive Compensation Plan	361,054	$ 11.04	623,250

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, 2008 and the reinvestment of all dividends.

Comparison of Five-Year Cumulative Total Return

Company or Index	2008	2009	2010	2011	2012	2013
Communications Systems, Inc.	$ 100.000	$ 168.093	$ 199.115	$ 207.241	$ 162.342	$ 184.442
NASDAQ US	100.000	143.741	170.174	171.081	202.398	281.914
NASDAQ TELCOM	100.000	149.951	193.615	204.735	276.614	401.346

(f) RECENT SALES OF UNREGISTERED SECURITIES

Not applicable.

(g) PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

The Company did not repurchase any shares of common stock during the three months ended December 31, 2013:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
October 2013		$		411,910
November 2013				411,910
December 2013				411,910
Total		$		411,910

(1) Shares represent remaining amount of a 500,000 share repurchase authorization approved by the Company s Board in October 2008 and publicly announced in November 2008.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data has been derived from our consolidated financial statements and should be read in conjunction with the Consolidated Financial Statements and related notes thereto set forth in Item 8 and with Management s Discussion and Analysis of Financial Condition and Results of Operations included in Item 7 of this Annual Report on Form 10-K.

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

	Year Ended December 31				
	2013	**2012**	**2011**	**2010**	**2009**
Selected Income Statement Data					
Sales	$ 131,320	$ 104,250	$ 143,775	$ 120,072	$ 109,792
Costs and Expenses:					
Cost of Sales	86,421	62,753	84,880	68,872	67,944
Selling, General and Administrative Expenses	36,743	38,101	40,108	35,586	31,433
Impairment loss	5,850		1,272		196
Restructuring expense	1,149				
Total Costs and Expenses	130,163	100,854	126,260	104,458	99,573
Operating Income	1,157	3,396	17,515	15,614	10,219
Other (Expense) Income, Net	(53)	2	105	20	581
Income Before Income Taxes	1,104	3,398	17,620	15,634	10,800
Income Tax Expense	2,061	1,160	7,822	5,919	4,756
Net (Loss) Income	$ (957)	$ 2,238	$ 9,798	$ 9,715	$ 6,044
Basic Net (Loss) Income Per Share	$ (0.11)	$ 0.26	$ 1.16	$ 1.16	$ 0.72
Diluted Net (Loss) Income Per Share	$ (0.11)	$ 0.26	$ 1.15	$ 1.15	$ 0.72
Cash Dividends Declared Per Share	$ 0.64	$ 0.64	$ 0.60	$ 0.59	$ 0.52
Average Dilutive Shares Outstanding	8,531	8,519	8,496	8,415	8,352
Selected Balance Sheet Data					
Total Assets	$ 103,533	$ 112,535	$ 116,659	$ 109,070	$ 102,914
Property, Plant and Equipment, Net	14,941	14,475	14,019	13,214	13,322
Long-term Liabilities	1,838	3,298	3,741	5,004	4,220
Stockholders Equity	88,622	93,995	97,531	91,397	85,939

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

Overview

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

Suttle manufactures and sells copper and fiber connectivity products, enclosure systems, xDSL filters and splitters, and active technologies for voice, data and video communications under the Suttle brand in the United States and internationally;

Transition Networks designs, assembles and sells NIDs, media converter devices, Ethernet switches and other connectivity products that make it possible to transmit telecommunications signals between systems using different types of media; and

JDL Technologies provides technology solutions including virtualization, managed services, wired and wireless network design and implementation services, and converged infrastructure configuration and deployment.

Key 2013 Developments

The Company s 2013 sales were $131.3 million, a 26% increase compared to 2012 sales of $104.2 million.

The Company s 2013 net loss was $958,000, or ($0.11) per diluted share, compared to net income of $2.2 million or $0.26 per diluted share in fiscal 2012. The Company had a goodwill write-off totaling $5.8 million during 2013. The impact of this goodwill impairment loss on 2013 net income was approximately $4.8 million or $0.56 per share.

At 2013 year end, the Company had cash, cash equivalents and investments of $29.7 million and positive working capital of $70.6 million.

During 2013, the Company took a series of actions that culminated in the adoption of a restructuring and revitalization plan on September 4, 2013. On that date, the Company s Chairman became Interim Chief Executive Officer and the Company appointed a new Chief Financial Officer. This revitalization plan is designed to strengthen the Company s business by focusing all operational and financial responsibility at the business unit level, reducing corporate overhead expenses, and aggressively reducing costs in order to free up resources for investments in growth. Implementation of this plan continued in the 2013 fourth quarter. The Company incurred 2013 expenses of $1.1 million in connection with the restructuring, including significant severance payments.

Suttle achieved strong growth in fiscal 2013 posting sales of $54.3 million, a 21% increase over fiscal 2012. As a result of increased efficiencies associated with the higher sales level and favorable product mix, Suttle s gross margin increased to 29% in 2013 compared to 27% in 2012. Suttle s operating income increased to $5,457,000 in 2013 from $2,603,000 in 2012.

Transition Networks fiscal 2013 sales decreased 19% to $43.9 million compared to $53.8 million in 2012. Gross margins generally remained steady in 2013, dropping slightly to 51% in the 2013 as compared to 52% in 2012. Transition Networks incurred an operating loss of $3.2 million in 2013 compared to operating income of $5.9 million in 2012 due to the write off of goodwill totaling $5.8 million in the 2013 third quarter. Because of declining product sales in its existing markets, Transition Networks is focused on developing new products for key growth markets, particularly telecommunications carriers.

JDL Technologies fiscal 2013 sales were $33.1 million compared to $5.4 million in 2012 due to substantially increased sales to its two South Florida school district customers. JDL reported 2013 operating income of $4.0 million compared to a 2012 operating loss of $655,000. Federal and local funding for investments in IT infrastructure and services for K-12 schools varies substantially from year to year. There have been large swings in JDL s annual revenues over the past several years. This volatility in JDL s annual revenues is expected to continue in 2014 and future years, and accordingly, in order to reduce its dependence on government funding, JDL continues to aggressively pursue revenue opportunities in the small to medium size IT services business market. Its revenue from these commercial businesses increased to $2.2 million in 2013 from $1.3 million in 2012.

Forward Looking Statements

In this report and from time to time, in reports filed with the Securities and Exchange Commission, in press releases, and in other communications to shareholders or the investing public, we 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. For a detailed discussion of a number of such risk factors, please see Item 1A above.

Critical Accounting Policies

Inventory Valuation: We value inventories at the lower of cost or market. We estimate and record reserves for inventory overstock and obsolescence to reduce the carrying value to estimated net realizable value. We determine the reserve amount based on on projected sales information, plans for discontinued products and other factors. Though we consider these reserves adequate and proper, changes in sales volumes due to unexpected economic or competitive conditions are among the factors that could materially affect the adequacy of this reserve.

Income Taxes: In the preparation of the Company s consolidated financial statements, management calculates income taxes. This includes estimating the Company s current tax liability as well as assessing temporary 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. These assets and liabilities are analyzed regularly and management assesses the likelihood it will realize these deferred assets from future taxable income. We determine the valuation allowance for deferred income tax benefits based upon the expectation of whether the benefits are more likely than not to be realized. The Company records interest and penalties related to income taxes as income tax expense in the Consolidated Statements of Income.

Goodwill Impairment: We are required to evaluate goodwill for impairment on an annual basis and between annual tests upon the occurrence of certain events or circumstances. We perform a two-step process to analyze whether or not goodwill has been impaired. Step one is to test for potential impairment, and requires that we compare the fair value of the reporting unit to its book value including goodwill. If the fair value is higher than the book value, no impairment is recognized. The Company estimates the fair value of each reporting unit based on a discounted cash flow analysis. If the fair value is lower than the book value, a second step must be performed. The second step is to measure the amount of impairment loss, if any, and requires that a hypothetical purchase price allocation be done to determine the implied fair value of goodwill. This fair value is then compared to the carrying value of goodwill. If the implied fair value is lower than the carrying value, an impairment adjustment must be recorded.

In developing our discounted cash flow analysis, assumptions about future revenues and expenses, capital expenditures and changes in working capital are based on our annual operating plan and long-term business plan for each of our reporting units. These plans consider many factors including historical experience, anticipated future economic conditions and growth expectations for the industries and end markets in which we participate. These assumptions are determined over a five-year, long-term planning period. Revenues and operating profit beyond the five-year period are projected to grow at a nominal perpetual growth rate for all reporting units. The discount rate calculations are determined by assuming a company beta, market premium risk, size premium, the cost of debt and debt-to-capital ratio of a market participant.

The Company believes that accounting estimates related to goodwill impairment are critical because the underlying assumptions used for the discounted cash flow analysis can change from period to period and could potentially cause a material impact to the income statement. Management s assumptions about inflation rates and other internal and external economic conditions, such as earnings growth rate, require significant judgment based on fluctuating rates and expected revenues. Based on the step one and step two analysis, considering Transition Networks reduced earnings and cash flow forecasts, the Company determined that Transition Networks goodwill was fully impaired and recorded a goodwill impairment for this segment of $5,850,000 in the third quarter of 2013.

Revenue Recognition: The Company recognizes revenue when the earnings process is complete, evidenced by persuasive evidence of an agreement, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectability is reasonably assured. In the Suttle and Transition Networks segments, the earning process completion is evidenced through the shipment of goods, based on the sales terms of these segments, the risk of loss is transferred upon shipment or delivery to customers and there are no significant obligations subsequent to that point. There are not significant estimates related to revenue recognition for these segments.

JDL Technologies records revenue on hardware, software and related equipment sales and installation contracts when the revenue recognition criteria are met and the products are installed and accepted by the customer. JDL records revenue on service contracts on a straight-line basis over the contract period, unless evidence suggests that the revenue is earned in a different pattern. Each contract is individually reviewed to determine when the earnings process is complete.

Results of Operations

2013 Compared to 2012

Sales were $131,320,000 in 2013, a 26% increase from sales of $104,250,000 in 2012. Operating income decreased 66% to $1,156,000 in 2013 as compared to $3,396,000 in 2012. Income before income taxes decreased 68% to $1,103,000 from $3,398,000 in 2012. Net income decreased 143% to a net loss of $958,000 in 2013 compared to income of $2,238,000 in 2012.

Suttle

Suttle sales increased 21% to $54,346,000 in 2013 compared to $45,030,000 in 2012. Sales by product groups in 2013 and 2012 were:

	Suttle Sales by Product Group	
	2013	**2012**
Modular connecting products	$ 14,077,000	$ 13,428,000
DSL products	8,057,000	8,254,000
Structured cabling products	26,900,000	18,081,000
Other products	5,312,000	5,267,000
	$ 54,346,000	$ 45,030,000

Suttle s sales by customer groups in 2013 and 2012 were:

	Suttle Sales by Customer Group	
	2013	**2012**
Telecommunication customers	$ 43,296,000	$ 33,645,000
Distributors	5,938,000	5,540,000
International	4,547,000	5,394,000
Other	565,000	451,000
	$ 54,346,000	$ 45,030,000

The increase in sales is due primarily to increased sales to Suttle s domestic telecommunication customers. Sales to these customers increased 29% to $43,296,000 in 2013 compared to $33,645,000 in 2012 due to fulfillment of new contracts for recently introduced Suttle products and increased sales tied to enhanced network deployments by telecommunication service providers. Sales to these customers accounted for 80% of Suttle s sales in 2013 compared to 75% of sales in 2012. Sales to distributors increased 7% and accounted for 11% of sales in 2013 compared to 12% in 2012. The increase in this customer group is a result of increased opportunities in the domestic market for new single family unit (SFU) and multi-dwelling unit (MDU) construction. International sales accounted for 8% of Suttle s 2013 sales, but declined 16% compared to 2012. The decrease in sales in this customer group is due to a reduction in revenue from Austin Taylor s legacy products, including the termination of a non-profitable OEM contract.

Modular connecting products sales increased 5% due to an increase in new MDU construction in the U.S. housing market and an increase in sales tied to enhanced network deployments. Sales of structured cabling products increased 49% due to increased MDU construction activity in the U.S housing market and an increase in sales tied to enhanced network deployments. Sales of DSL products decreased 2% due to the maturation of the market and increased pricing pressures.

Suttle s gross margin increased 32% to $15,812,000 in 2013 compared to $11,974,000 in 2012. The gross margin percentage increased to 29% in 2013 compared to 27% in 2012 due to product mix changes and increased production levels.

Selling, general and administrative expenses increased $983,000, or 10% to $10,354,000 in 2013 compared to $9,371,000 in 2012 due to continued investment into new product development and market expansion initiatives.

Suttle s operating income increased 110% to $5,457,000 in 2013 from $2,603,000 in 2012.

Transition Networks

Transition Networks designs and markets media conversion products, Ethernet switches, and other connectivity and data transmission products. Characteristics of the business include a rapid pace of change in technologies and alternative solutions to our products. Transition Networks derives the majority of its revenues from one-time network upgrade projects. The core markets for these products are enterprise, service providers, and industrial users. Roughly 70% of Transition Networks revenue comes from North America, but we continue to see opportunity for long-term growth outside of North America and we will invest resources in sales, marketing, and infrastructure to grow that business.

Transition Networks sales decreased 19% to $43,857,000 in 2013 compared to $53,843,000 in 2012. Transition Networks organizes its sales force by vertical markets and segments its customers geographically. Sales by customer groups in 2013 and 2012 were:

	Transition Networks Sales by Region	
	2013	**2012**
North America	$ 30,661,000	$ 39,386,000
EMEA	5,145,000	5,744,000
Rest of world	8,051,000	8,713,000
	$ 43,857,000	$ 53,843,000

The following table summarizes Transition Networks 2013 and 2012 sales by product group:

	Transition Networks Sales by Product Group	
	2013	**2012**
Media converters	$ 31,940,000	$ 35,817,000
Ethernet switches	4,394,000	4,738,000
Ethernet adapters	4,165,000	4,948,000
Other products	3,358,000	8,340,000
	$ 43,857,000	$ 53,843,000

Sales in North America decreased 22% in 2013, or $8,725,000 compared to 2012 due to declines in Federal government spending and delays in certain programs. International sales decreased $1,261,000, or 9%, due to currency fluctuations, project timing and continuing economic problems in certain countries.

Gross margin decreased 20% to $22,419,000 in 2013 compared to $27,995,000 in 2012. Gross margin as a percentage of sales decreased to 51% in 2013 compared to 52% in 2012 due to unfavorable product mix.

Selling, general and administrative expenses decreased 11% to $19,765,000 in 2013 from $22,106,000 in 2012 due to corporate restructuring and cost reduction measures taken throughout the year. Due to the goodwill write-off totaling $5,850,000 in the third quarter of 2013, operating income decreased 163% to an operating loss of $3,711,000 in 2013 compared to operating income of $5,888,000 in 2012.

Transition Networks will continue to develop products based on market needs as well as by following industry standards set by such organizations as the Institute of Electrical and Electronics Engineers and the Metro Ethernet Forum. We will also continue to invest in sales and marketing to grow revenues in our target markets and expand sales outside of North America.

JDL Technologies, Inc.

Sales by JDL Technologies, Inc. (the Company s IT services business unit) increased 516% to $33,116,000 in 2013 compared to $5,377,000 in 2012. The following table summarizes JDL s revenues by customer group in 2013 and 2012:

	JDL Revenue by Customer Group	
	2013	2012
Broward County FL schools	$ 7,928,000	$ 3,265,000
Miami Dade County FL schools	22,988,000	825,000
All other	2,200,000	1,287,000
	$ 33,116,000	$ 5,377,000

Revenues earned in Broward County FL increased $4,663,000 or 143% in 2013 due to the E-Rate 15 initiative, which was significantly larger than the prior year s initiative. Revenues earned in Miami Dade County are related to the district s Bringing Wireless to the Classroom initiative for which the district was granted federal funding under the E-Rate program to expand wireless connectivity for students and staff. All other revenues increased $913,000 due to JDL s concentrated effort to grow its revenues from small to medium sized businesses.

JDL gross margin increased 336% to $6,668,000 in 2013 compared to $1,529,000 in 2012. Gross margin as a percentage of sales decreased to 20% in 2013 from 28% in 2012 reflecting the fact that a significant portion of its 2013 revenue was hardware-based, rather than JDL s more traditional value-added service.

Selling, general and administrative expenses increased 20% in 2013 to $2,629,000 compared to $2,184,000 in 2012 due to the year over year growth of the sales and administration teams required to manage JDL s continued expansion in both education and commercial markets. JDL reported operating income of $4,039,000 in 2013 compared to an operating loss of $655,000 in 2012.

Although JDL Technologies will continue to aggressively pursue opportunities at both M-DCPS and SBBC, it has substantially completed the present phase of its work on the Bringing Wireless to the Classroom initiative and other projects, and currently has a substantially lower backlog for future projects. Because federal and local funding for investments in IT infrastructure and services for K-12 schools varies substantially from year to year, there have been large swings in JDL s annual revenues over the past several years. We expect this volatility in JDL s annual revenues to continue in 2014 and future years. Accordingly, in order to reduce its dependence on government funding, JDL continues to aggressively pursue opportunities to provide managed services, migration to the cloud, virtualization and other network services for small and medium sized commercial businesses with a focus on healthcare, legal and financial services markets.

Other

Income before income taxes decreased 68% to $1,103,000 in 2013 compared to $3,398,000 in 2012. The Company s effective income tax rate was 187% in 2013 compared to 34% in 2012. The 2013 effective rate was significantly higher than the standard rate of 35% primarily because the Company incurred a $5.8 million goodwill impairment charge in 2013, the majority of which was not deductible for income tax purposes, as discussed in Note 11 to the consolidated financial statements. Other factors affecting the effective income tax rate include state income taxes, foreign losses not deductible for U.S. income tax purposes, provisions for interest charges for uncertain income tax positions, and the effect of operations conducted in lower foreign tax rate jurisdictions. The 2012 effective rate was lower than the standard rate of 35% due to state income taxes, the release of valuation allowance placed on foreign net operating losses, and the effect of operations conducted in lower foreign tax rate jurisdictions.

2012 Compared to 2011

Sales were $104,250,000 in 2012, a 27% decrease from sales of $143,775,000 in 2011. Operating income decreased 81% to $3,396,000 in 2012 as compared to $17,515,000 in 2011. Income before income taxes decreased 81% to $3,398,000 from $17,620,000 in 2011. Net income decreased 77% to $2,238,000 in 2012 compared to $9,798,000 in 2011.

Suttle

Suttle sales increased 13% to $45,030,000 in 2012 compared to $39,924,000 in 2011. Sales by product groups in 2012 and 2011 were:

	Suttle Sales by Product Group	
	2012	2011
Modular connecting products	$ 13,428,000	$ 12,662,000
DSL products	8,254,000	10,146,000
Structured cabling products	18,081,000	12,302,000
Other products	5,267,000	4,814,000
	$ 45,030,000	$ 39,924,000

Suttle s sales by customer groups in 2012 and 2011 were:

	Suttle Sales by Customer Group	
	2012	2011
Telecommunication customers	$ 33,645,000	$ 27,124,000
Distributors	5,540,000	4,461,000
International	5,394,000	7,874,000
Other	451,000	465,000
	$ 45,030,000	$ 39,924,000

The increase in sales is due primarily to increased sales to Suttle s domestic telecommunication customers. Sales to the telephone companies increased 24% to $33,645,000 in 2012 compared to $27,124,000 in 2011 due to fulfillment of new product contracts and increased sales tied to enhanced network deployments. Sales to these customers accounted for 75% of Suttle s sales in 2012 compared to 68% of sales in 2011. Sales to distributors decreased 24% and accounted for 12% of sales in 2012 compared to 11% in 2011. The increase in this customer group is a result of increased opportunities in the domestic market for new single family unit (SFU) and multi-dwelling unit (MDU) construction. International sales accounted for 12% of Suttle s 2012 sales but declined 31% compared to 2011. The decrease in sales in this customer group is due to a delay in DSL sales to a large customer, discontinuation of Austin Taylor s metal business, and reduction in revenue from Austin Taylor s legacy products.

Modular connecting products sales increased 6% due to an increase in new MDU construction in the U.S. housing market and an increase in sales tied to enhanced network deployments. Sales of structured cabling products increased 47% due to increased construction activity in the MDU space in specific regions in the U.S and an increase in sales tied to enhanced network deployments. Sales of DSL products decreased 19%

due to the maturation of the U.S. DSL market and order cycles of major customers.

Suttle s gross margin increased 31% to $11,974,000 in 2012 compared to $9,132,000 in 2011. The gross margin percentage was 27% in 2012 compared to 23% in 2011 due to product mix changes and increased production levels.

Selling, general and administrative expenses increased $1,153,000, or 14% to $9,371,000 in 2012 compared to $8,218,000 in 2011 due to an increase in spending in the technology development and market expansion initiatives.

Suttle s operating income increased to $2,603,000 in 2012 from an operating loss of $358,000 in 2011 due to a goodwill impairment charge of $1,272,000 in the second quarter of 2011 and an overall reduction of losses from Austin Taylor s operations in 2012.

Transition Networks

Transition Networks sales decreased 41% to $53,843,000 in 2012 compared to $91,450,000 in 2011 due primarily to $32,751,000 in 2011 revenue from a one-time large network upgrade project with a Fortune 500 company. Revenues excluding this major project decreased 12% or $5,311,000 as compared to the prior year due to a continued slowdown in federal government spending. Transition Networks organizes its sales force by vertical markets and segments its customers geographically. Sales by customer groups in 2012 and 2011 were:

	Transition Networks Sales by Region	
	2012	2011
North America	$ 39,386,000	$ 77,448,000
EMEA	5,744,000	7,178,000
Rest of world	8,713,000	6,824,000
	$ 53,843,000	$ 91,450,000

The following table summarizes Transition Networks 2012 and 2011 sales by product group:

	Transition Networks Sales by Product Group	
	2012	2011
Media converters	$ 35,817,000	$ 72,781,000
Ethernet switches	4,738,000	4,523,000
Ethernet adapters	4,948,000	6,422,000
Other products	8,340,000	7,724,000
	$ 53,843,000	$ 91,450,000

Sales in North America decreased 49% or $38,062,000 compared to 2011 due to revenue from a one-time large network upgrade project with a Fortune 500 company that was completed during the third quarter of 2011. This also resulted in the decrease in media converter revenue. Other vertical markets, especially the federal government market in the United States, recorded lower revenue due to the slow down in government purchases resulting in project delays. International sales increased $455,000, or 3%, due to a strong rebound in the orders from Asian Telco customers in deploying data services as well as Circuit Emulation Services.

Gross margin decreased 37% to $27,995,000 in 2012 compared to $44,625,000 in 2011. Gross margin as a percentage of sales increased to 52% in 2012 compared to 49% in 2011 due to volume discounts given for the large network upgrade project with the Fortune 500 company described above.

Selling, general and administrative expenses decreased 7% to $22,106,000 in 2012 from $23,731,000 in 2011 due to cost reduction measures taken in the second and third quarters of 2012. Operating income decreased 72% to $5,888,000 in 2012 compared to $20,894,000 in 2011 due to the 2011 completion of the one-time large network upgrade project with a Fortune 500 company.

JDL Technologies, Inc.

Sales by JDL Technologies, Inc. decreased 57% to $5,377,000 in 2012 compared to $12,401,000 in 2011. The following table summarizes JDL s revenues by customer group in 2012 and 2011:

	JDL Revenue by Customer Group	
	2012	2011
Broward County FL schools	$ 3,265,000	$ 11,621,000
All other	2,112,000	780,000
	$ 5,377,000	$ 12,401,000

Revenues earned in Broward County FL decreased $8,356,000 or 72% in 2012. In the first quarter of 2010, the Company received significant funding for federal government contract work. This contract work was of a long-term nature, and the Company completed these contracts during the quarter ended September 30, 2011. All other revenues increased $1,332,000 due to JDL s concentrated effort to expand its market focus.

JDL gross margin decreased 70% to $1,529,000 in 2012 compared to $5,139,000 in 2011. Gross margin as a percentage of sales decreased to 28% in 2012 from 41% in 2011 due to purchasing discounts and rebates the Company was able to take advantage of during the prior year.

Selling, general and administrative expenses increased 10% in 2012 to $2,184,000 compared to $1,982,000 in 2011 due to an increase in the sales and marketing headcount as JDL expands into the commercial markets. JDL reported an operating loss of $655,000 in 2012 compared to operating income of $3,156,000 in 2011.

Other

Income before income taxes decreased 81% to $3,398,000 in 2012 compared to $17,620,000 in 2011. The Company s effective income tax rate was 34% in 2012 compared to 44% in 2011. The 2012 effective rate was lower than the standard rate of 35% due to state income taxes, the release of valuation allowance placed on foreign net operating losses, and the effect of operations conducted in lower foreign tax rate jurisdictions. The 2011 effective rate was higher than the standard rate of 35% due to state income taxes, foreign losses not deductible for U.S. income tax purposes, provisions for interest charges, goodwill impairment, and acquisition costs not deductible for income tax purposes.

Acquisitions and Dispositions

The Company is a growth-oriented manufacturer of telecommunications connecting and networking devices. The Company continually searches for acquisition candidates with products that will enable the Company to better serve its target markets.

Effects of Inflation

Inflation has not had a significant effect on operations. The Company does not have long-term production or procurement contracts and has historically been able to adjust pricing and purchasing decisions to respond to inflationary pressures.

Liquidity and Capital Resources

As of December 31, 2013, the Company had approximately $29,722,000 in cash, cash equivalents and investments. Of this amount, $5,752,000 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 and certificates of deposit, which are fully insured through the FDIC. The Company also had $9,663,000 in investments consisting of certificates of deposit and corporate notes and bonds that are traded on the open market and are classified as available-for-sale at December 31, 2013.

The Company had working capital of $70,599,000, consisting of current assets of approximately $83,672,000 and current liabilities of $13,073,000 at December 31, 2013 compared to working capital of $70,677,000, consisting of current assets of $85,918,000 and current liabilities of $15,241,000 at the end of 2012.

Cash flow provided by operating activities was approximately $803,000 in 2013 compared to $200,000 provided by operations in 2012. Significant working capital changes from 2012 to 2013 included an increase in receivables of $8,207,000 and lower inventories of $4,648,000 due to higher sales in 2013 and a smaller need for inventory, specifically related to the Suttle and JDL Technologies business units as compared to 2012.

Cash provided by investing activities was $5,775,000 in 2013 compared to cash provided of $3,035,000 in 2012. The Company continued to make capital investments and purchases of certificates of deposit and other marketable securities. The Company made withdrawals from investments during the year in excess of purchases in order to fund operations, specifically related to the JDL projects during the year.

Net cash used by financing activities was $4,390,000 in 2013 compared to $7,924,000 in 2012. Cash dividends paid on common stock decreased to $4,099,000 in 2013 ($0.48 per common share) from $6,734,000 in 2012 ($0.79 per common share). The decrease in cash dividends paid in 2013 is related to the early payment of the dividend declared in December 2012, which ordinarily would have been paid in January of the following year. Proceeds from common stock issuances, principally shares sold to the Company s Employee Stock Ownership Plan and under the Company s Employee Stock Purchase Plan, totaled approximately $311,000 in 2013 and $298,000 in 2012. The Company purchased and retired no shares in 2013 and 70,028 shares for $758,000 in 2012. At December 31, 2013, Board of Director authority to purchase approximately 411,910 additional shares remained in effect.

As part of the acquisition of the new Minnetonka headquarters building in July 2007, the Company assumed an outstanding mortgage of $4,380,000. The mortgage is payable in monthly installments and carries an interest rate of 6.83%. The mortgage matures on March 1, 2016. Mortgage payments on principal totaled $457,000 during 2013. The outstanding balance on the mortgage was $1,118,000 at December 31, 2013.

The Company expects that its fiscal 2014 effective income tax rate will be approximately 34%.

The Company had no outstanding obligations under its line of credit at December 31, 2013 and 2012, and the Company s entire credit line ($10,000,000 at March 1, 2014) is available for use. Interest on borrowings on the credit line is at LIBOR plus 1.1% (1.3% at December 31, 2013). There were no borrowings on the line of credit during 2013 or 2012. The credit agreement expires October 31, 2014 and is secured by assets of the Company. The Company intends to renew the agreement in 2014. 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.

Contractual Obligation Summary

The following table summarizes our contractual obligations at December 31, 2013 and the effect these obligations are expected to have on our liquidity and cash flow in future periods:

	Less than One Year	1 3 Years	3 5 Years	More Than 5 Years
Long-term debt	$ 490,000	$ 628,000	$	$
Interest on long-term debt	61,000	28,000		
Pensions	414,000	267,000	497,000	1,411,000
Operating leases	287,000	306,000		
Compensation plans	199,000			
Total	$ 1,451,000	$ 1,229,000	$ 497,000	$ 1,411,000

As of December 31, 2013, the Company had $401,000 in uncertain tax positions for which we are unable to reasonably estimate in which future periods they will ultimately be settled.

As of December 31, 2013, the Company had no other material commitments (either cancelable or non-cancelable) for capital expenditures, short or long term debt, capital leases or other purchase commitments related to ongoing operations.

Recently Issued Accounting Pronouncements

We do not believe there are any recently issued accounting standards that have not yet been adopted that will have a material impact on the Company s financial statements.

Off Balance Sheet Arrangements

None.

ITEM 7A. 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 December 31, 2013 our bank line of credit carried a LIBOR rate plus 1.1%. The Company s investments are money market, certificates of deposit, commercial paper, and corporate notes and bonds types of investments that earn interest at prevailing market rates and as such do not have material risk exposure.

Based on the Company s operations, in the opinion of management, the Company is not exposed to material future losses due to market risk.

The Company uses the U.S. dollar as its functional currency in Costa Rica and China. Accordingly, the Company believes its risk of material loss due to fluctuations in foreign currency markets to be small.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
(a) FINANCIAL STATEMENTS

REPORT OF MANAGEMENT

The management of Communications Systems, Inc. and its subsidiary companies is responsible for the integrity and objectivity of the financial statements and other financial information contained in the annual report. The financial statements and related information were prepared in accordance with accounting principles generally accepted in the United States of America and include amounts that are based on management s informed judgments and estimates.

In fulfilling its responsibilities for the integrity of financial information, management maintains accounting systems and related controls. These controls provide reasonable assurance, at appropriate costs, that assets are safeguarded against losses and that financial records are reliable for use in preparing financial statements. Management recognizes its responsibility for conducting the Company s affairs according to the highest standards of personal and corporate conduct.

The Audit Committee of the Board of Directors, comprised solely of outside directors, meets with the independent auditors and management periodically to review accounting, auditing, financial reporting and internal control matters. The independent auditors have free access to this committee, without management present, to discuss the results of their audit work and their opinion on the adequacy of internal financial controls and the quality of financial reporting.

/s/ Curtis A. Sampson

Curtis A. Sampson
Interim Chief Executive Officer

/s/ Edwin C. Freeman

Edwin C. Freeman
Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Communications Systems, Inc.:

We have audited the accompanying consolidated balance sheets of Communications Systems, Inc., and subsidiaries (the Company) as of December 31, 2013 and 2012, and the related consolidated statements of income (loss) and comprehensive income (loss), changes in stockholders equity, and cash flows for each of the three years in the period ended December 31, 2013. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Communications Systems, Inc. and subsidiaries at December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control-Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2014 expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ Deloitte & Touche LLP

Minneapolis, Minnesota
March 14, 2014

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Communications Systems, Inc.:

We have audited the internal control over financial reporting of Communications Systems Inc., and subsidiaries (the Company) as of December 31, 2013, based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel 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. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2013 of the Company and our report dated March 14, 2014, expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ Deloitte & Touche LLP

Minneapolis, Minnesota
March 14, 2014

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31 2013	December 31 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 20,059,120	$ 17,869,712
Investments	5,742,314	12,701,538
Trade accounts receivable, less allowance for doubtful accounts of $69,000 and $69,000, respectively	22,902,323	14,683,227
Inventories	29,111,656	33,752,710
Prepaid income taxes	1,381,502	2,113,926
Other current assets	716,784	783,352
Deferred income taxes	3,758,750	4,013,628
TOTAL CURRENT ASSETS	83,672,449	85,918,093
PROPERTY, PLANT AND EQUIPMENT, net	14,941,492	14,474,913
OTHER ASSETS:		
Investments	3,920,978	5,376,397
Goodwill		5,956,934
Funded pension assets	305,028	
Other assets	692,794	808,308
TOTAL OTHER ASSETS	4,918,800	12,141,639
TOTAL ASSETS	$ 103,532,741	$ 112,534,645
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	$ 489,706	$ 457,464
Accounts payable	4,894,869	9,237,233
Accrued compensation and benefits	3,927,728	3,044,864
Accrued consideration	558,801	770,041
Other accrued liabilities	1,765,428	1,670,009
Dividends payable	1,436,318	61,833
TOTAL CURRENT LIABILITIES	13,072,850	15,241,444
LONG TERM LIABILITIES:		
Long-term compensation plans		350,457
Uncertain tax positions	400,846	320,426
Deferred income taxes	809,179	1,381,785
Pension liabilities		127,611
Long-term debt - mortgage payable	627,823	1,117,529
TOTAL LONG-TERM LIABILITIES	1,837,848	3,297,808
COMMITMENTS AND CONTINGENCIES (Footnote 8)		
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; 8,553,320 and 8,474,896 shares issued and outstanding, respectively	427,666	423,745
Additional paid-in capital	37,110,671	36,404,518
Retained earnings	51,323,718	57,755,178
Accumulated other comprehensive loss	(240,012)	(588,048)

TOTAL STOCKHOLDERS EQUITY	88,622,043	93,995,393
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 103,532,741	$ 112,534,645

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

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

	Year Ended December 31		
	2013	**2012**	**2011**
Sales	$ 131,319,510	$ 104,249,654	$ 143,775,051
Costs and expenses:			
Cost of sales	86,420,982	62,752,763	84,879,924
Selling, general and administrative expenses	36,742,869	38,100,773	40,108,221
Impairment loss	5,849,853		1,271,986
Restructuring expense	1,149,439		
Total costs and expenses	130,163,143	100,853,536	126,260,131
Operating income	1,156,367	3,396,118	17,514,920
Other income and (expenses):			
Investment and other income	125,985	75,187	313,544
(Loss)/gain on sale of assets	(73,126)	62,630	(27,081)
Interest and other expense	(106,101)	(136,255)	(181,393)
Other income (loss), net	(53,242)	1,562	105,070
Income from operations before income taxes	1,103,125	3,397,680	17,619,990
Income tax expense	2,061,013	1,159,566	7,822,124
Net (loss) income	(957,888)	2,238,114	9,797,866
Other comprehensive income (loss), net of tax:			
Additional minimum pension liability adjustments	37,000	1,311,000	(525,000)
Unrealized (losses)/gains on available-for-sale securities	(21,964)	26,223	(16,691)
Foreign currency translation adjustment	333,000	(2,032,877)	934,934
Total other comprehensive (loss) income	348,036	(695,654)	393,243
Comprehensive (loss) income	$ (609,852)	$ 1,542,460	$ 10,191,109
Basic net (loss) income per share:	$ (0.11)	$ .26	$ 1.16
Diluted net (loss) income per share:	$ (0.11)	$ .26	$ 1.15
Weighted Average Basic Shares Outstanding	8,531,073	8,508,497	8,448,612
Weighted Average Dilutive Shares Outstanding	8,531,073	8,518,613	8,495,873

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

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
BALANCE AT DECEMBER 31, 2010	8,422,890	$ 421,144	$ 34,491,370	$ 56,769,816	$ (285,637)	$ 91,396,693
Net income				9,797,866		9,797,866
Issuance of common stock under Employee Stock Purchase Plan	10,308	515	151,761			152,276
Issuance of common stock to Employee Stock Ownership Plan	22,493	1,125	314,902			316,027
Issuance of common stock under Employee Stock Option Plan	9,000	450	72,450			72,900
Issuance of common stock under Executive Stock Plan	2,083	105	31,974			32,079
Tax benefit from non-qualified employee stock options			21,920			21,920
Share based compensation			448,896			448,896
Shareholder dividends ($0.60 per share)				(5,101,340)		(5,101,340)
Other comprehensive income					393,243	393,243
BALANCE AT DECEMBER 31, 2011	8,466,774	423,339	35,533,273	61,466,342	107,606	97,530,560
Net income				2,238,114		2,238,114
Issuance of common stock under Employee Stock Purchase Plan	13,849	692	171,078			171,770
Issuance of common stock to Employee Stock Ownership Plan	36,145	1,807	506,391			508,198
Issuance of common stock under Non-Employee Stock Option Plan	12,000	600	84,983			85,583
Issuance of common stock under Executive Stock Plan	16,156	808	39,503			40,311
Tax benefit from non-qualified stock options			67,835			67,835
Share based compensation			302,964			302,964
Purchase of common stock	(70,028)	(3,501)	(301,509)	(452,941)		(757,951)
Shareholder dividends ($0.64 per share)				(5,496,336)		(5,496,336)
Other comprehensive loss					(695,654)	(695,654)
BALANCE AT DECEMBER 31, 2012	8,474,896	423,745	36,404,518	57,755,178	(588,048)	93,995,393
Net loss				(957,888)		(957,888)
Issuance of common stock under Employee Stock Purchase Plan	16,977	849	172,354			173,203
Issuance of common stock to Employee Stock Ownership Plan	44,598	2,230	461,589			463,819
Issuance of common stock under Non-Employee Stock Option Plan	15,000	750	109,500			110,250
Issuance of common stock under Executive Stock Plan	1,849	92	27,312			27,404
Tax benefit from non-qualified stock options			16,284			16,284
Share based compensation			(80,886)			(80,886)
Shareholder dividends ($0.64 per share)				(5,473,572)		(5,473,572)
Other comprehensive income					348,036	348,036
BALANCE AT DECEMBER 31, 2013	8,553,320	427,666	37,110,671	51,323,718	(240,012)	88,622,043

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

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

	Year Ended December 31		
	2013	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss) income	$ (957,888)	$ 2,238,114	$ 9,797,866
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	2,184,830	2,133,511	2,100,735
Share based compensation	(80,886)	302,964	448,896
Deferred taxes	(317,727)	(631,626)	1,695,595
Impairment loss	5,849,853		1,271,986
Change in fair value of acquisition-related contingent consideration	(43,898)	85,501	
Loss/(gain) on sale of assets	73,126	(62,630)	27,081
Excess tax benefit from share based payments	(16,284)	(67,835)	(21,920)
Changes in assets and liabilities net of effects from acquisitions:			
Trade receivables	(8,207,253)	(189,775)	3,273,730
Inventories	4,647,916	(7,705,772)	(602,414)
Prepaid income taxes	732,618	1,776,601	(3,600,652)
Other assets	89,533	252,378	(78,349)
Accounts payable	(4,342,626)	4,819,481	(1,025,703)
Accrued compensation and benefits	994,012	(2,250,647)	751,925
Other accrued liabilities	71,293	(680,171)	395,133
Income taxes payable	96,704	(15,168)	(335,374)
Other		195,244	(32,022)
Net cash provided by operating activities	773,323	200,170	14,066,513
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(2,699,347)	(2,607,958)	(2,755,991)
Purchases of investments	(4,401,321)	(15,010,778)	(20,884,014)
Acquisition of business			(3,138,367)
Proceeds from the sale of fixed assets	82,078	198,109	22,555
Proceeds from the sale of investments	12,794,000	20,456,039	23,635,385
Net cash provided by (used in) investing activities	5,775,410	3,035,412	(3,120,432)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Cash dividends paid	(4,099,087)	(6,734,466)	(5,064,811)
Mortgage principal payments	(457,464)	(427,345)	(399,209)
Proceeds from issuance of common stock	310,857	297,664	257,255
Excess tax benefit from stock based payments	16,284	67,835	21,920
Payment of contingent consideration related to acquisition	(161,060)	(370,096)	
Purchase of common stock		(757,951)	
Net cash used in financing activities	(4,390,470)	(7,924,359)	(5,184,845)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	31,145	42,779	(33,084)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,189,408	(4,645,998)	5,728,152
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	17,869,712	22,515,710	16,787,558
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 20,059,120	$ 17,869,712	$ 22,515,710
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Income taxes paid	$ 1,556,590	$ 87,343	$ 10,037,938
Interest paid	106,101	138,477	165,514

Dividends declared not paid	1,436,318	1,270,016
Acquisition costs in accrued liabilities		1,002,623

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

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2013, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of business: Communications Systems, Inc. (herein collectively called CSI, our or the Company) is a Minnesota corporation organized in 1969 that operates directly and through its subsidiaries located in the United States, Costa Rica, the United Kingdom and China. CSI is principally engaged through its Suttle business unit 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 of media and rate conversion products for telecommunications networks. CSI also provides through its JDL Technologies business unit IT solutions including network design, computer infrastructure installations, IT service management, change management, network security and network operations services.

The Company classifies its businesses into three 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; and *JDL Technologies, (JDL*), which provides IT services; non-allocated general and administrative expenses are separately accounted for as Other in the Company s segment reporting. There are no material intersegment revenues.

Principles of consolidation: The consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany transactions and accounts have been eliminated.

Use of estimates: The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company uses estimates based on the best information available in recording transactions and balances resulting from operations. Actual results could differ from those estimates. The Company s estimates consist principally of reserves for doubtful accounts, sales returns, warranty costs, asset impairment evaluations, accruals for compensation plans, self-insured medical and dental accruals, pension liabilities, lower of cost or market inventory adjustments, provisions for income taxes and deferred taxes and depreciable lives of fixed assets.

Cash equivalents: For purposes of the consolidated statements of cash flows, the Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents. As of December 31, 2013, the Company had $20,059,000 in cash and cash equivalents. Of this amount, $5,752,000 was invested in short-term money market funds that are not considered to be bank deposits and are not insured or guaranteed by the federal deposit insurance company (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 is operating cash and certificates of deposit which are fully insured through the FDIC.

Investments: Investments consist of certificates of deposit, commercial paper, and corporate notes and bonds that are traded on the open market and are classified as available-for-sale at December 31, 2013. Available-for-sale investments are reported at fair value with unrealized gains and losses excluded from operations and reported as a separate component of stockholders equity, net of tax (see Accumulated Comprehensive income below).

Inventories: Inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out method. Provision to reduce inventories to the lower of cost or market is made based on a review of excess and obsolete inventories, estimates of future sales, examination of historical consumption rates and the related value of component parts.

Property, plant and equipment: Property, plant and equipment are recorded at cost. Depreciation is computed using the straight-line method. Depreciation included in cost of sales and selling, general and administrative expenses for continuing operations was $2,083,000, $2,030,000 and $2,058,000 for 2013, 2012 and 2011, respectively. Maintenance and repairs are charged to operations and additions or improvements are capitalized. Items of property sold, retired or otherwise disposed of are removed from the asset and accumulated depreciation accounts and any gains or losses on disposal are reflected in operations.

Goodwill and Other Intangible Assets: Goodwill represents the amount by which the purchase prices (including liabilities assumed) of acquired businesses exceed the estimated fair value of the net tangible assets and separately identifiable assets of these businesses. Goodwill and intangible assets with indefinite useful lives are not amortized, but are tested at least annually for impairment. The Company reassesses the value of our reporting units and related goodwill balances at the end of each fiscal year and at other times if events have occurred or circumstances exist that indicate the carrying amount of goodwill may not be recoverable. Based on the step one and step two analysis, considering Transition Networks reduced earnings and cash flow forecasts, the Company determined that Transition Networks goodwill was fully impaired and recorded a goodwill impairment for this segment of $5,850,000 in the third quarter of 2013.

Recoverability of long-lived assets: The Company reviews its long-lived assets periodically to determine potential impairment by comparing the carrying value of the assets with expected net cash flows expected to be provided by operating activities of the business or related products. If the sum of the expected future net cash flows is less than the carrying value, an impairment loss would be measured by comparing the amount by which the carrying value exceeds the fair value of the asset.

Warranty: The Company 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 following table presents the changes in the Company s warranty liability for the years ended December 31, 2013 and 2012, which relate to normal product warranties and a five-year obligation to provide for potential future liabilities for certain network equipment sales:

	Year Ended December 31	
	2013	**2012**