UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2015**

OR

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

For the transition period from ____________________ to ____________________

Commission File Number: 001-31588

COMMUNICATIONS SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

MINNESOTA	41-0957999

(State or other jurisdiction of incorporation or organization)	(Federal Employer Identification No.)
10900 Red Circle Drive, Minnetonka, MN	55343
(Address of principal executive offices)	(Zip Code)

(952) 996-1674

Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant has submitted electronically 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 NO

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	**Name of Exchange On Which Registered**	**Outstanding at August 1, 2015**
Common Stock, par value	NASDAQ	8,744,631

$.05 per share

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

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

	June 30 2015	December 31 2014
CURRENT ASSETS:		
Cash and cash equivalents	$7,972,407	$13,736,857
Investments	2,884,792	4,602,717
Trade accounts receivable, less allowance for doubtful accounts of $147,000 and $22,000, respectively	17,353,120	13,839,662
Inventories	29,320,866	31,109,653
Prepaid income taxes	4,813,137	2,317,688
Other current assets	873,443	1,050,000
Deferred income taxes	3,175,986	3,249,164
TOTAL CURRENT ASSETS	66,393,751	69,905,741
PROPERTY, PLANT AND EQUIPMENT, net	18,218,327	18,153,152
OTHER ASSETS:		
Investments	10,576,393	11,540,261
Goodwill	1,455,784	—
Funded pension assets	147,665	172,405
Other assets	779,112	514,676
TOTAL OTHER ASSETS	12,958,954	12,227,342
TOTAL ASSETS	$97,571,032	100,286,235
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	$370,175	$524,220
Line of credit borrowings	3,100,000	—
Accounts payable	6,570,684	5,180,631
Accrued compensation and benefits	3,584,913	3,696,930
Accrued consideration	462,870	—
Other accrued liabilities	1,895,580	2,146,582
Dividends payable	1,455,216	1,446,498
TOTAL CURRENT LIABILITIES	17,439,438	12,994,861
LONG TERM LIABILITIES:		
Uncertain tax positions	78,372	77,279

Deferred income taxes	1,039,587	1,089,994
Long-term debt - mortgage payable	—	103,603
TOTAL LONG-TERM LIABILITIES	1,117,959	1,270,876
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; 8,739,858 and 8,654,756 shares issued and outstanding, respectively	436,993	432,738
Additional paid-in capital	39,709,299	38,593,230
Retained earnings	39,565,581	47,689,688
Accumulated other comprehensive loss	(698,238)	(695,158)
TOTAL STOCKHOLDERS' EQUITY	79,013,635	86,020,498
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$97,571,032	$100,286,235

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

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

	Three Months Ended June 30		Six Months Ended June 30	
	2015	2014	2015	2014
Sales	$28,197,661	$33,208,977	$47,742,597	$58,407,383
Costs and expenses:				
Cost of sales	19,658,792	21,115,209	34,316,789	37,325,598
Selling, general and administrative expenses	10,256,538	9,688,247	20,834,714	18,690,358
Restructuring expense	—	—	—	237,838
Total costs and expenses	29,915,330	30,803,456	55,151,503	56,253,794
Operating (loss) income	(1,717,669)	2,405,521	(7,408,906)	2,153,589
Other expenses :				
Investment and other income	3,897	28,065	66,857	34,024
Gain (loss) on sale of assets	88	(141,870)	4,373	(136,131)
Interest and other expense	(61,044)	(16,391)	(74,262)	(41,046)
Other expense, net	(57,059)	(130,196)	(3,032)	(143,153)
(Loss) income from operations before income taxes	(1,774,728)	2,275,325	(7,411,938)	2,010,436
Income tax (benefit) expense	(746,562)	837,842	(2,220,294)	713,536
Net (loss) income	(1,028,166)	1,437,483	(5,191,644)	1,296,900
Other comprehensive income (loss), net of tax:				
Additional minimum pension liability adjustments	(14,152)	(91,447)	(26,798)	(178,790)
Unrealized (loss)/gain on available-for-sale securities	(5,193)	8,280	49,926	(14,610)
Foreign currency translation adjustment	104,109	55,994	(26,208)	82,545
Total other comprehensive income (loss)	84,764	(27,173)	(3,080)	(110,855)
Comprehensive (loss) income	$(943,402)	$1,410,310	$(5,194,724)	$1,186,045
Basic net (loss) income per share:	$(0.12)	$0.17	$(0.60)	$0.15
Diluted net (loss) income per share:	$(0.12)	$0.17	$(0.60)	$0.15
Weighted Average Basic Shares Outstanding	8,707,564	8,621,387	8,684,321	8,593,561
Weighted Average Dilutive Shares Outstanding	8,707,564	8,644,505	8,684,321	8,616,858
Dividends declared per share	$0.16	$0.16	$0.32	$0.32

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

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

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
BALANCE AT DECEMBER 31, 2014	8,654,756	$432,738	$38,593,230	$47,689,688	$(695,158)	$86,020,498
Net loss				(5,191,644)		(5,191,644)
Issuance of common stock under Employee Stock Purchase Plan	8,794	440	96,283			96,723
Issuance of common stock to Employee Stock Ownership Plan	36,707	1,835	383,588			385,423
Issuance of common stock under Non-Employee Stock Option Plan	12,000	600	121,920			122,520
Issuance of common stock under Executive Stock Plan	43,244	2,162	0			2,162
Tax benefit from stock based payments			85,399			85,399
Share based compensation			499,475			499,475
Purchase of common stock	(15,643)	(782)	(70,596)	(103,961)		(175,339)
Shareholder dividends				(2,828,502)		(2,828,502)
Other comprehensive loss					(3,080)	(3,080)
BALANCE AT JUNE 30, 2015	8,739,858	$436,993	$39,709,299	$39,565,581	$(698,238)	$79,013,635

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

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

	Six Months Ended June 30	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(5,191,644)	$1,296,900
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	1,633,260	1,143,272
Share based compensation	499,475	240,485
Deferred taxes	22,772	278,601
(Gain) loss on sale of assets	(4,373)	136,131
Excess tax benefit from share-based payments	(85,399)	(75,425)
Changes in assets and liabilities:		
Trade receivables	(3,475,720)	3,743,374
Inventories	1,797,692	(1,934,942)
Prepaid income taxes	(2,495,449)	397,360
Other assets	(130,430)	135,705
Accounts payable	1,304,217	2,079,869
Accrued compensation and benefits	273,601	(12,258)
Other accrued liabilities	(297,840)	127,808
Income taxes payable	86,492	(3,753)
Other	(58,224)	—
Net cash (used in) provided by operating activities	(6,121,570)	7,553,127
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(1,654,960)	(2,495,463)
Purchases of investments	—	(9,872,086)
Acquisition of business, net of cash acquired	(917,363)	—
Proceeds from the sale of fixed assets	22,941	15,993
Proceeds from the sale of investments	2,731,718	3,020,000
Net cash provided by (used in) investing activities	182,336	(9,331,556)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings against line of credit	3,100,000	—
Cash dividends paid	(2,819,784)	(2,800,528)
Mortgage principal payments	(257,648)	(240,684)
Proceeds from issuance of common stock, net of shares withheld	46,066	180,394
Excess tax benefit from share-based payments	85,399	75,425
Payment of contingent consideration related to acquisition	—	(565,647)
Purchase of common stock	—	(2,161)
Net cash provided by (used in) financing activities	154,033	(3,353,201)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	20,751	24,942
NET DECREASE IN CASH AND CASH EQUIVALENTS	(5,764,450)	(5,106,688)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	13,736,857	20,059,120
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$7,972,407	$14,952,432

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Income taxes paid	$52,979	$30,763
Interest paid	28,931	41,046
Dividends declared not paid	1,455,216	1,419,807
Capital expenditures in accounts payable	6,000	50,871
Acquisition costs in accrued consideration	462,870	—

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

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COMMUNICATIONS SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Communications Systems, Inc. (herein collectively called “CSI” or the “Company”) is a Minnesota corporation organized in 1969 that operates primarily as a holding company conducting its business through three business units having operations in the United States, Costa Rica, and the United Kingdom. Through its Suttle business unit, the Company manufactures and sells copper and fiber connectivity systems, enclosure systems, and active technologies for voice, data and video communications. Through its Transition Networks business unit, the Company manufactures and sells media converters, network interface devices, network interface cards, Ethernet switches and other connectivity products that offer the ability to affordably integrate the benefits of fiber optics into any data network. Through its JDL Technologies business unit, the Company provides technology solutions including virtualization, managed services, wired and wireless network design and implementation, HIPAA-compliant IT services, and converged infrastructure configuration and deployment.

Financial Statement Presentation

The condensed consolidated balance sheets and condensed consolidated statement of changes in stockholders’ equity as of June 30, 2015 and the related condensed consolidated statements of (loss) income and comprehensive (loss) income, and the condensed consolidated statements of cash flows for the periods ended June 30, 2015 and 2014 have been prepared by Company management. In the opinion of management, all adjustments (which include only normal recurring adjustments, except where noted) necessary to present fairly the financial position, results of operations, and cash flows at June 30, 2015 and 2014 and for the periods then ended have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted. We recommend these condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company’s December 31, 2014 Annual Report to Shareholders on Form 10-K. The results of operations for the period ended June 30, 2015 are not necessarily indicative of operating results for the entire year.

The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the balance sheet date, and the reported amounts of revenues and expenses during the reporting period. The estimates and assumptions used in the accompanying condensed consolidated financial statements are based upon management's evaluation of the relevant facts and circumstances as of the time of the financial statements. Actual results could differ from those estimates.

Except to the extent updated or described below, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, appropriately represent, in all material respects, the current status of accounting policies, and are incorporated herein by reference.

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Accumulated Other Comprehensive Loss

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

	June 30 2015	December 31 2014
Foreign currency translation	$(2,632,000)	$(2,605,000)
Unrealized gain/(loss) on available-for-sale investments	9,000	(41,000)
Pension liability adjustment	1,925,000	1,951,000
	$(698,000)	$(695,000)

NOTE 2 – CASH EQUIVALENTS AND INVESTMENTS

The following tables show the Company's cash equivalents and available-for-sale securities' amortized cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or short and long term investments as of June 30, 2015 and December 31, 2014:

	June 30, 2015						
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**Cash Equivalents**	**Short-Term Investments**	**Long-Term Investments**
Cash equivalents:							
Money Market funds	$2,473,000	$ —	$ —	$2,473,000	$2,473,000	$	$
Subtotal	2,473,000	—	—	2,473,000	2,473,000	—	—
Investments:							
Certificates of deposit	5,973,000	12,000	(1,000)	5,984,000	—	962,000	5,022,000
Corporate Notes/Bonds	7,487,000	2,000	(12,000)	7,477,000	—	1,923,000	5,554,000
Subtotal	13,460,000	14,000	(13,000)	13,461,000	—	2,885,000	10,576,000
Total	$15,933,000	$ 14,000	$ (13,000)	$15,934,000	$2,473,000	$2,885,000	$10,576,000

December 31, 2014

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash Equivalents	Short-Term Investments	Long-Term Investments
Cash equivalents:							
Money Market funds	$1,073,000	$ —	$ —	$1,073,000	$1,073,000	$	$
Subtotal	1,073,000	—	—	1,073,000	1,073,000	—	—
Investments:							
Certificates of deposit	7,414,000	1,000	(32,000)	7,383,000	—	1,920,000	5,463,000
Corporate Notes/Bonds	8,777,000	6,000	(23,000)	8,760,000	—	2,683,000	6,077,000
Subtotal	16,191,000	7,000	(55,000)	16,143,000	—	4,603,000	11,540,000
Total	$17,264,000	$ 7,000	$ (55,000)	$17,216,000	$1,073,000	$4,603,000	$11,540,000

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The Company tests for other-than-temporary losses on a quarterly basis and has considered the unrealized losses indicated above to be temporary in nature. The Company intends to hold the investments until it can recover the full principal amount and has the ability to do so based on other sources of liquidity. The Company expects these recoveries to occur prior to the contractual maturities. All unrealized losses as of June 30, 2015 were in a continuous unrealized loss position for less than twelve months and are not deemed to be other than temporarily impaired as of June 30, 2015.

The following table summarizes the estimated fair value of our investments, designated as available-for-sale and classified by the contractual maturity date of the securities as of June 30, 2015:

	Amortized Cost	Estimated Market Value
Due within one year	$2,884,000	$2,885,000
Due after one year through five years	10,576,000	10,576,000
	$13,460,000	$13,461,000

The Company did not recognize any gross realized gains, and gross realized losses were immaterial, during the six-month periods ending June 30, 2015 and 2014, respectively. If the Company had realized gains or losses, they would be included within investment and other income in the accompanying consolidated results of operations.

NOTE 3 - STOCK-BASED COMPENSATION

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan ("ESPP"), employees are able to acquire shares of common stock at 85% of the price at the end of each current quarterly plan term. The most recent term ended June 30, 2015. The ESPP is considered compensatory under current Internal Revenue Service rules. At June 30, 2015, after giving effect to the shares issued as of that date, 112,689 shares remain available for purchase under the ESPP.

2011 Executive Incentive Compensation Plan

On March 28, 2011 the Board adopted and on May 19, 2011 the Company's shareholders approved the Company's 2011 Executive Incentive Compensation Plan ("2011 Incentive Plan"). The 2011 Incentive Plan authorizes incentive awards to officers, key employees and non-employee directors in the form of options (incentive and non-qualified), stock appreciation rights, restricted stock, restricted stock units, performance stock units ("deferred stock"), performance cash units, and other awards in stock, cash, or a combination of stock and cash. On May 21, 2015, the Company's shareholders approved an amendment to the 2011 Incentive Plan to increase the authorized shares by 1,000,000 to 2,000,000. As a result, up to 2,000,000 shares of our common stock may be issued pursuant to awards under the 2011 Incentive Plan, as amended.

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During 2015, stock options covering 248,258 shares have been awarded to key executive employees and directors. These options expire seven years from the date of award and vest 25% each year beginning one year after the date of award. The Company has also granted deferred stock awards of 100,017 shares to key employees during the first quarter of 2015 under the Company's long-term incentive plan for performance over the 2015 to 2017 period. The actual number of shares of deferred stock, if any, that are ultimately earned by the respective employees will be determined based on achievement against performance goals for each of the three years ending December 31, 2017 and the shares earned will be issued in the first quarter of 2018 to those key employees still with the Company at that time.

At June 30, 2015, 104,455 shares have been issued under the 2011 Incentive Plan, 840,213 shares are subject to currently outstanding options, deferred stock awards, and unvested restricted stock units, and 1,055,332 shares are eligible for grant under future awards. On May 21, 2015, the Company's shareholders approved an amendment to the 2011 Stock Incentive plan to increase the authorized shares by 1,000,000 to 2,000,000.

Stock Option Plan for Directors

Shares of common stock are reserved for issuance to non-employee directors under options granted by the Company prior to 2011 under its Stock Option Plan for Non-Employee Directors (the "Director Plan"). Under the Director Plan nonqualified stock options to acquire shares of common stock were automatically granted to each non-employee director concurrent with annual meetings of shareholders in 2010 and earlier years, with the exercise price of options granted being the fair market value of the common stock on the date of the respective shareholder meetings. Options granted under the Director Plan expire 10 years from date of grant. No options were granted under the Director Plan in 2014 or 2015. The Company amended the Director Plan in May 2011 to prohibit future option grants.

1992 Stock Plan

Under the Company's 1992 Stock Plan ("the Stock Plan"), shares of common stock may be issued pursuant to stock options, restricted stock or deferred stock grants to officers and key employees. Exercise prices of stock options under the Stock Plan cannot be less than fair market value of the stock on the date of grant. Rules and conditions governing awards of stock options, restricted stock and deferred stock are determined by the Compensation Committee of the Board of Directors, subject to certain limitations in the Stock Plan. The Company amended the Stock Plan in 2011 to prohibit future stock options or other equity awards.

At June 30, 2015, after reserving for stock options and deferred stock awards granted in prior years and adjusting for forfeitures and issuances during the year, there were 22,008 shares reserved for issuance under the Stock Plan. The Company has not awarded stock options or deferred stock under the Stock Plan since 2011.

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Changes in Stock Options Outstanding

The following table summarizes changes in the number of outstanding stock options under the 2011 Incentive Plan, the Director Plan and Stock Plan over the period December 31, 2014 to June 30, 2015:

	Options	Weighted average exercise price per share	Weighted average remaining contractual term
Outstanding – December 31, 2014	540,404	$ 11.90	5.13
Awarded	248,258	11.31	
Exercised	(12,000)	11.05	
Forfeited	(47,984)	12.10	
Outstanding – June 30, 2015	728,678	11.71	5.40
Exercisable at June 30, 2015	297,439	$ 11.73	4.09
Expected to vest June 30, 2015	728,678	11.71	5.40

The aggregate intrinsic value of all options (the amount by which the market price of the stock on the last day of the period exceeded the market price of the stock on the date of grant) outstanding at June 30, 2015 was $51,000. The intrinsic value of all options exercised during the six months ended June 30, 2015 was $10,000. Net cash proceeds from the exercise of all stock options were $0 and $99,000 for the six months ended June 30, 2015 and 2014.

Changes in Deferred Stock Outstanding

The following table summarizes the changes in the number of deferred stock shares under the Stock Plan and 2011 Incentive Plan over the period December 31, 2014 to June 30, 2015:

	Shares	Weighted Average Grant Date Fair Value
Outstanding – December 31, 2014	161,314	$10.87
Granted	100,017	11.59
Vested	(16,940)	12.52
Forfeited	(5,991)	10.26

Outstanding – June 30, 2015	238,400	11.07

Changes in Restricted Stock Units Outstanding

The following table summarizes the changes in the number of restricted stock units under the 2011 Incentive Plan over the period December 31, 2014 to June 30, 2015:

	Shares	**Weighted Average Grant Date Fair Value**
Outstanding – December 31, 2014	39,151	$ 10.67
Granted	21,432	11.06
Issued	(26,304)	10.01
Forfeited	—	—
Outstanding – June 30, 2015	34,279	11.42

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Compensation Expense

Share-based compensation expense recognized for the six-month period ended June 30, 2015 was $499,000 before income taxes and $325,000 after income taxes. Share-based compensation expense recognized for the six-month period ended June 30, 2014 was $240,000 before income taxes and $156,000 after income taxes. Unrecognized compensation expense for the Company’s plans was $1,305,000 at June 30, 2015 and is expected to be recognized over a weighted-average period of 2.2 years. Excess tax benefits from the exercise of stock options and issuance of stock included in financing cash flows for the six month periods ended June 30, 2015 and 2014 were $85,000 and $75,000, respectively. Share-based compensation expense is recorded as a part of selling, general and administrative expenses.

NOTE 4 - INVENTORIES

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

	June 30 2015	**December 31 2014**
Finished goods	$16,249,000	$19,208,000
Raw and processed materials	13,072,000	11,902,000
	$29,321,000	$31,110,000

NOTE 5 – ACQUISITION

On June 1, 2015, the Company acquired all of the shares of Twisted Technologies, Inc. (“Twisted Technologies”). The purchase price totals $1,454,000, with cash acquired totaling $83,000. The purchase price includes initial consideration of $1,000,000, deferred consideration of $300,000 to be paid out on March 31, 2016, $ (9,000) in working capital adjustments, and $163,000 in estimated contingent consideration. The Company has agreed to pay consideration contingent upon the Twisted Technologies business meeting revenue targets over a three year period, with the consideration to be paid after each annual period has lapsed. The Company has recognized $163,000 as the estimated fair value of the contingent consideration at the date of acquisition. The maximum payout is not limited. At June 30, 2015, the Company had estimated liabilities of $463,000 related to outstanding consideration payments.

The estimated assets and liabilities of Twisted Technologies were recorded in the consolidated balance sheet within the JDL Technologies segment at June 30, 2015. The preliminary purchase price allocation was based on estimates of the fair value of assets acquired and liabilities assumed and included total assets of $1,582,000, including estimated goodwill of $1,456,000, and total liabilities of $128,000. The entire goodwill balance is deductible for tax purposes. All balances recorded are estimated amounts; the purchase price allocation will be finalized as the Company completes its valuation of identifiable assets and liabilities. The pro forma impact of Twisted Technologies was not significant to the Company’s results for the three and six months ended June 30, 2015.

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NOTE 6 –GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the six months ended June 30, 2015 by segment are as follows:

	JDL
January 1, 2015	$—
Goodwill acquired	1,456,000
June 30, 2015	$1,456,000
Gross goodwill	1,456,000
Accumulated impairment loss	
Balance at June 30, 2015	$1,456,000

The Company’s identifiable intangible assets with finite lives are being amortized over their estimated useful lives and were as follows:

	June 30, 2015			
	Gross Carrying Amount	**Accumulated Amortization**	**Foreign Currency Translation**	**Net**
Trademarks	91,000	(45,000)	(3,000)	43,000
Customer relationships	491,000	(185,000)	(19,000)	287,000
Technology	229,000	(172,000)	(9,000)	48,000
	811,000	(402,000)	(31,000)	378,000

	December 31, 2014			
	Gross Carrying Amount	**Accumulated Amortization**	**Foreign Currency Translation**	**Net**
Trademarks	91,000	(38,000)	(4,000)	49,000
Customer relationships	491,000	(159,000)	(26,000)	306,000
Technology	229,000	(149,000)	(11,000)	69,000
	811,000	(346,000)	(41,000)	424,000

Amortization expense on these identifiable intangible assets was $50,000 and $54,000 for the six-month periods ended June 30, 2015 and 2014, respectively. The amortization expense is included in selling, general and administrative expenses. At June 30, 2015, the estimated future amortization expense for definite-lived intangible assets for the remainder of 2015 and all of the following four fiscal years is as follows:

Year Ending December 31:	
2015	$51,000
2016	83,000
2017	58,000
2018	53,000
2019	46,000

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NOTE 7 – WARRANTY

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

The following table presents the changes in the Company's warranty liability for the six-month periods ended June 30, 2015 and 2014, respectively, the majority of which relates to a five-year obligation to provide for potential future liabilities for network equipment sales.

	2015	**2014**
Beginning balance	$434,000	$564,000
Amounts charged to expense	174,000	(10,000)
Actual warranty costs paid	(50,000)	(60,000)
Ending balance	$558,000	$494,000

NOTE 8 – CONTINGENCIES

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

NOTE 9 – DEBT

Long-term Debt

The mortgage on the Company's headquarters building is payable in monthly installments and carries an interest rate of 6.83%. The mortgage matures on March 1, 2016. The outstanding balance on the mortgage was $370,000 at June 30, 2015. The mortgage is secured by the building.

Line of Credit

The Company has a $10,000,000 line of credit from Wells Fargo Bank. The Company had $3,100,000 in outstanding borrowings against the line of credit at June 30, 2015 and no borrowings at June 30, 2014. Due to the revolving nature of loans under our credit facility, additional borrowings and periodic repayments and re-borrowings may be made until the maturity date. The total amount available for borrowings under our credit facility at June 30, 2015 was $6,900,000. Interest on borrowings on the credit line is at LIBOR plus 1.75% (1.9% at June 30, 2015). The credit agreement expires October 31, 2016 and is secured by assets of the Company. Our credit agreement contains financial covenants including current ratio, net income, tangible net worth minimums, and a minimum cash balance. The Company was in compliance with its financial covenants at June 30, 2015. See Note 16 for a description of an amendment to the credit facility subsequent to quarter end.

NOTE 10 – INCOME TAXES

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

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At June 30, 2015 there was $77,000 of net uncertain tax benefit positions that would reduce the effective income tax rate if recognized. The Company records interest and penalties related to income taxes as income tax expense in the Condensed Consolidated Statements of Income.

The Company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. The tax years 2011-2013 remain open to examination by the Internal Revenue Service and the years 2010-2013 remain open to examination by various state tax departments. The tax years from 2011-2013 remain open in Costa Rica.

The Company's effective income tax rate was 30.0% for the first six months of 2015. The effective tax rate differs from the federal tax rate of 35% due to state income taxes, foreign tax rate differences, foreign losses not deductible for U.S. income tax purposes and expenses not deductible for tax purposes. The foreign operating losses may ultimately be deductible in the countries in which they occurred; however the Company has not recorded a deferred tax asset for these losses due to uncertainty regarding the eventual realization of the benefit. The effect of the foreign operations was an overall rate decrease of approximately 2.2% for the six months ended June 30, 2015. There were no additional uncertain tax positions identified in the first six months of 2015. The Company's effective income tax rate for the six months ended June 30, 2014 was 35.5%, and differed from the federal tax rate due to state income taxes, foreign losses not deductible for U.S. income tax purposes, provisions for interest charges for uncertain income tax positions, and settlement of uncertain tax positions.

NOTE 11 – SEGMENT INFORMATION

The Company classifies its businesses into three segments as follows:

- Suttle manufactures and sells copper and fiber connectivity systems, enclosure systems, xDSL filters and splitters, and active technologies for voice, data and video communications;
- Transition Networks manufactures and sells media converters, network interface devices (NIDs), network interface cards (NICs), Ethernet switches and other connectivity products that offer the ability to affordably integrate the benefits of fiber optics into any data network; and
- JDL Technologies provides technology solutions including virtualization, managed services, wired and wireless network design and implementation, HIPAA-compliant IT services, and converged infrastructure configuration and deployment.

Management has chosen to organize the enterprise and disclose reportable segments based on our products and services. Intersegment revenues are eliminated upon consolidation.

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Information concerning the Company's continuing operations in the various segments for the three and six-month periods ended June 30, 2015 and 2014 is as follows:

	Suttle	Transition Networks	JDL Technologies	Other	Intersegment Eliminations	Total
Three Months Ended June 30, 2015						
Sales	$11,788,000	$11,915,000	$4,718,000	$—	$(223,000)	$28,198,000
Cost of sales	9,533,000	6,508,000	3,618,000	—	—	19,659,000
Gross profit	2,255,000	5,407,000	1,100,000	—	(223,000)	8,539,000
Selling, general and administrative expenses	3,504,000	5,920,000	1,056,000	—	(223,000)	10,257,000
Operating (loss) income	$(1,249,000)	$(513,000)	$44,000	$—	$—	$(1,718,000)
Depreciation and amortization	$546,000	$267,000	$38,000	$—	$—	$851,000
Capital expenditures	$518,000	$127,000	$127,000	$30,000	$—	$802,000
Assets	$41,872,000	$26,674,000	$4,212,000	$24,813,000	$—	$97,571,000

	Suttle	Transition Networks	JDL Technologies	Other	Intersegment Eliminations	Total
Three Months Ended June 30, 2014						
Sales	$19,006,000	$11,567,000	$2,636,000	$—	$ —	$33,209,000
Cost of sales	12,731,000	6,182,000	2,202,000	—	—	21,115,000
Gross profit	6,275,000	5,385,000	434,000	—	—	12,094,000
Selling, general and administrative expenses	3,358,000	5,609,000	721,000	—	—	9,688,000
Restructuring expense		—				—
Operating income (loss)	$2,917,000	$(224,000)	$(287,000)	$—	$ —	$2,406,000
Depreciation and amortization	$315,000	$231,000	$37,000	$—	$ —	$583,000
Capital expenditures	$1,295,000	$251,000	$8,000	$118,000	$ —	$1,672,000
Assets	$38,304,000	$27,507,000	$3,520,000	$34,468,000	$ —	$103,799,000

	Suttle	Transition Networks	JDL Technologies	Other	Intersegment Eliminations	Total
Six Months Ended June 30, 2015						

Sales	$22,378,000	$20,005,000	$5,583,000	$—	$(223,000)	$47,743,000
Cost of sales	18,682,000	11,193,000	4,442,000	—	—	34,317,000
Gross profit	3,696,000	8,812,000	1,141,000	—	(223,000)	13,426,000
Selling, general and administrative expenses	7,810,000	11,382,000	1,866,000	—	(223,000)	20,835,000
Operating loss	$(4,114,000)	$(2,570,000)	$(725,000)	$—	$—	$(7,409,000)
Depreciation and amortization	$1,053,000	$514,000	$66,000	$—	$—	$1,633,000
Capital expenditures	$1,167,000	$213,000	$170,000	$105,000	$—	$1,655,000

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	Suttle	Transition Networks	JDL Technologies	Other	Intersegment Eliminations	Total
Six Months Ended June 30, 2014						
Sales	$31,888,000	$21,317,000	$5,202,000	$—	$ —	$58,407,000
Cost of sales	22,123,000	11,224,000	3,978,000	—	—	37,325,000
Gross profit	9,765,000	10,093,000	1,224,000	—	—	21,082,000
Selling, general and administrative expenses	6,496,000	10,789,000	1,405,000	—	—	18,690,000
Restructuring expense		238,000				238,000
Operating income (loss)	$3,269,000	$(934,000)	$(181,000)	$—	$ —	$2,154,000
Depreciation and amortization	$608,000	$461,000	$74,000	$—	$ —	$1,143,000
Capital expenditures	$1,922,000	$359,000	$18,000	$196,000	$ —	$2,495,000

NOTE 12 – PENSIONS

The Company's U.K. based subsidiary Austin Taylor maintains defined benefit pension plans. The Company does not provide any other post-retirement benefits to its employees. Components of net periodic benefit of the pension plans for the three and six-months ended June 30, 2015 and 2014 were:

	Three Months Ended June 30		Six Months Ended June 30	
	2015	2014	2015	2014
Service cost	$2,000	$2,000	$4,000	$3,000
Interest cost	38,000	40,000	72,000	79,000
Expected return on assets	(50,000)	(52,000)	(95,000)	(101,000)
Net periodic pension benefit	$(10,000)	$(10,000)	$(19,000)	