COMMUNICATIONS SYSTEMS INC
Form 10-Q
August 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2014**

OR

o **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 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 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 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 Exchange Act. YES o NO x

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, 2014**
Common Stock, par value $.05 per share	NASDAQ	8,645,125

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES

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

		June 30 2014		December 31 2013
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	$	14,952,432	$	20,059,120
Investments		5,876,551		5,742,314
Trade accounts receivable, less allowance for doubtful accounts of $53,000 and $69,000, respectively		19,166,945		22,902,323
Inventories		31,080,110		29,111,656
Prepaid income taxes		984,430		1,381,502
Other current assets		637,897		716,784
Deferred income taxes		3,482,739		3,758,750
TOTAL CURRENT ASSETS		76,181,104		83,672,449
PROPERTY, PLANT AND EQUIPMENT, net		16,255,766		14,941,492
OTHER ASSETS:				
Investments		10,624,217		3,920,978
Funded pension assets		136,221		305,028
Other assets		601,394		692,794
TOTAL OTHER ASSETS		11,361,832		4,918,800
TOTAL ASSETS	$	103,798,702		103,532,741
LIABILITIES AND STOCKHOLDERS EQUITY				
CURRENT LIABILITIES:				
Current portion of long-term debt	$	506,669	$	489,706
Accounts payable		7,031,207		4,894,869
Accrued compensation and benefits		3,555,628		3,927,728
Accrued consideration				558,801
Other accrued liabilities		1,901,293		1,765,428
Dividends payable		1,419,807		1,436,318
TOTAL CURRENT LIABILITIES		14,414,604		13,072,850
LONG TERM LIABILITIES:				
Uncertain tax positions		321,668		400,846
Deferred income taxes		811,768		809,179
Long-term debt - mortgage payable		370,175		627,823
TOTAL LONG-TERM LIABILITIES		1,503,611		1,837,848
COMMITMENTS AND CONTINGENCIES (Footnote 7)				
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; 8,641,853 and 8,553,320 shares issued and outstanding, respectively		432,093		427,666
Additional paid-in capital		37,963,961		37,110,671
Retained earnings		49,835,300		51,323,718
Accumulated other comprehensive loss		(350,867)		(240,012)
TOTAL STOCKHOLDERS EQUITY		87,880,487		88,622,043
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	103,798,702	$	103,532,741

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 INCOME AND COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Sales	$ 33,208,977	$ 31,936,602	$ 58,407,383	$ 59,389,333
Costs and expenses:				
Cost of sales	21,115,209	20,408,285	37,325,598	38,085,089
Selling, general and administrative expenses	9,688,247	8,961,467	18,690,358	18,366,616
Restructuring expense			237,838	
Total costs and expenses	30,803,456	29,369,752	56,253,794	56,451,705
Operating income	2,405,521	2,566,850	2,153,589	2,937,628
Other (expenses) and income :				
Investment and other income	28,065	34,852	34,024	122,142
(Loss)/gain on sale of assets	(141,870)	2,585	(136,131)	(44,677)
Interest and other expense	(16,391)	(26,457)	(41,046)	(55,843)
Other (expense) income, net	(130,196)	10,980	(143,153)	21,622
Income from operations before income taxes	2,275,325	2,577,830	2,010,436	2,959,250
Income tax expense	837,842	939,273	713,536	1,078,334
Net income	1,437,483	1,638,557	1,296,900	1,880,916
Other comprehensive loss, net of tax:				
Additional minimum pension liability adjustments	(91,447)	(259)	(178,790)	(206,074)
Unrealized gain/(loss) on available-for-sale securities	8,280	(18,468)	(14,610)	(30,546)
Foreign currency translation adjustment	55,994	3,482	82,545	(339,672)
Total other comprehensive loss	(27,173)	(15,245)	(110,855)	(576,292)
Comprehensive income	$ 1,410,310	$ 1,623,312	$ 1,186,045	$ 1,304,624
Basic net income per share:	$ 0.17	$ 0.19	$ 0.15	$ 0.22
Diluted net income per share:	$ 0.17	$ 0.19	$ 0.15	$ 0.22
Weighted Average Basic Shares Outstanding	8,621,387	8,537,369	8,593,561	8,512,091
Weighted Average Dilutive Shares Outstanding	8,644,505	8,540,965	8,616,858	8,518,223
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 STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
BALANCE AT DECEMBER 31, 2013	8,553,320	$ 427,666	$ 37,110,671	$ 51,323,718	$ (240,012)	$ 88,622,043
Net loss				1,296,900		1,296,900
Issuance of common stock under Employee Stock Purchase Plan	6,574	329	78,823			79,152
Issuance of common stock to Employee Stock Ownership Plan	32,520	1,626	360,647			362,273
Issuance of common stock under Non-Employee Stock Option Plan	12,000	600	98,760			99,360
Issuance of common stock under Executive Stock Plan	37,633	1,882	0			1,882
Tax benefit from stock based payments			75,425			75,425
Share based compensation			240,485			240,485
Purchase of common stock	(194)	(10)	(850)	(1,301)		(2,161)
Shareholder dividends				(2,784,017)		(2,784,017)
Other comprehensive loss					(110,855)	(110,855)
BALANCE AT JUNE 30, 2014	8,641,853	$ 432,093	$ 37,963,961	$ 49,835,300	$ (350,867)	$ 87,880,487

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	
	2014	**2013**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,296,900	$ 1,880,916
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,143,272	1,058,654
Share based compensation	240,485	(50,702)
Deferred taxes	278,601	82,818
Change in fair value of acquisition-related contingent consideration		(342,834)
Loss on sale of assets	136,131	44,677
Excess tax benefit from share-based payments	(75,425)	(13,562)
Changes in assets and liabilities:		
Trade receivables	3,743,374	(6,543,186)
Inventories	(1,934,942)	(5,605,959)
Prepaid income taxes	397,360	2,126,336
Other assets	135,705	228,920
Accounts payable	2,079,869	(3,019,181)
Accrued compensation and benefits	(12,258)	340,746
Other accrued liabilities	127,808	248,973
Income taxes payable	(3,753)	284,445
Net cash provided by (used in) operating activities	7,553,127	(9,278,939)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(2,495,463)	(1,306,581)
Purchases of investments	(9,872,086)	(2,814,894)
Proceeds from the sale of fixed assets	15,993	36,184
Proceeds from the sale of investments	3,020,000	8,623,000
Net cash (used in) provided by investing activities	(9,331,556)	4,537,709
CASH FLOWS FROM FINANCING ACTIVITIES:		
Cash dividends paid	(2,800,528)	(1,363,527)
Mortgage principal payments	(240,684)	(224,838)
Proceeds from issuance of common stock	180,394	206,413
Excess tax benefit from share-based payments	75,425	13,562
Payment of contingent consideration related to acquisition	(565,647)	(161,060)
Purchase of common stock	(2,161)	
Net cash used in financing activities	(3,353,201)	(1,529,450)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	24,942	(68,810)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(5,106,688)	(6,339,490)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	20,059,120	17,869,712
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 14,952,432	$ 11,530,222
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Income taxes paid (refunded)	$ 30,763	$ (1,421,106)
Interest paid	41,046	53,733
Dividends declared not paid	1,419,807	1,363,795
Capital expenditures in accounts payable	50,871	

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, the United Kingdom and China. Through its Suttle business unit, the Company is principally engaged in the manufacture and sale of copper and fiber connectivity systems, enclosure systems, and active technologies for voice, data and video communications. Through its Transition Networks business unit, the Company is engaged in the manufacture of of network interface devices, media converters, 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, 2014 and the related condensed consolidated statements of income and comprehensive income, and the condensed consolidated statements of cash flows for the periods ended June 30, 2014 and 2013 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, 2014 and 2013 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, 2013 Annual Report to Shareholders on Form 10-K. The results of operations for the periods ended June 30, 2014 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, 2013, appropriately represent, in all material respects, the current status of accounting policies, and are incorporated herein by reference.

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Recent Accounting Pronouncements

In May 2014, the FASB issued guidance for revenue recognition for contracts, superseding the previous revenue recognition requirements, along with most existing industry-specific guidance. The guidance requires an entity to review contracts in five steps: 1) identify the contract, 2) identify performance obligations, 3) determine the transaction price, 4) allocate the transaction price, and 5) recognize revenue. The new standard will result in enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue arising from contracts with customers. The standard is effective for our reporting year beginning January 1, 2017 and early adoption is not permitted. We are currently evaluating the impact, if any, this new accounting pronouncement will have on our financial statements.

Accumulated Other Comprehensive Loss

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

	June 30 2014	December 31 2013
Foreign currency translation	$ (1,955,000)	$ (2,038,000)
Unrealized (loss)/gain on available-for-sale investments	(13,000)	2,000
Pension liability adjustment	1,617,000	1,796,000
	$ (351,000)	$ (240,000)

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, 2014 and December 31, 2013:

June 30, 2014

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash Equivalents	Short-Term Investments	Long-Term Investments
Cash equivalents:							
Money Market funds	$ 5,198,202	$	$	$ 5,198,202	$ 5,198,202	$	$
Subtotal	5,198,202			5,198,202	5,198,202		
Investments:							
Certificates of deposit	5,969,139	1,315	(7,355)	5,963,099		2,881,947	3,081,152
Corporate Notes/Bonds	10,528,236	20,820	(11,387)	10,537,669		2,994,604	7,543,065
Subtotal	16,497,375	22,135	(18,742)	16,500,768		5,876,551	10,624,217
Total	$ 21,695,577	$ 22,135	$ (18,742)	$ 21,698,970	$ 5,198,202	$ 5,876,551	$ 10,624,217

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December 31, 2013

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash Equivalents	Short-Term Investments	Long-Term Investments
Cash equivalents:							
Money Market funds	$ 5,751,965	$	$	$ 5,751,965	$ 5,751,965	$	$
Subtotal	5,751,965			5,751,965	5,751,965		
Investments:							
Certificates of deposit	4,024,031	687	(4,992)	4,019,726	239,904	2,582,502	1,197,320
Corporate Notes/Bonds	5,861,162	22,830	(522)	5,883,470		3,159,812	2,723,658
Subtotal	9,885,193	23,517	(5,514)	9,903,196	239,904	5,742,314	3,920,978
Total	$ 15,637,158	$ 23,517	$ (5,514)	$ 15,655,161	$ 5,991,869	$ 5,742,314	$ 3,920,978

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, 2014 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, 2014.

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, 2014:

	Amortized Cost	Estimated Market Value
Due within one year	$ 5,869,780	$ 5,876,551
Due after one year through five years	10,627,595	10,624,217
	$ 16,497,375	$ 16,500,768

The Company did not recognize any gross realized gains, and gross realized losses were immaterial, during the six-month periods ending June 30, 2014 and 2013, 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.

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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 90% of the price at the end of each current quarterly plan term. The most recent term ended June 30, 2014. The ESPP is considered compensatory under current Internal Revenue Service rules. At June 30, 2014, after giving effect to the shares issued as of that date, 29,013 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. Up to 1,000,000 shares of our common stock may be issued pursuant to awards under the 2011 Incentive Plan.

During 2014, stock options covering 300,246 shares were awarded to key executive employees and directors, which options expire seven years from the date of award and vest 25% each year beginning one year after the date of award. The Company also granted deferred stock awards of 43,824 shares to key employees during 2014 under the Company s long-term incentive plan that vest over three years with the first vesting period at March 28, 2015.

At June 30, 2014, 279,768 shares remained available for future issuance under the 2011 Incentive Plan.

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 2013 or 2014. The Director Plan was amended as of May 19, 2011 to prohibit option grants in 2011 and future years.

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. When seeking approval of the 2011 Incentive Plan at the 2011 Annual Meeting of Shareholders, the Company committed to amending the Stock Plan to prohibit the issuance of future equity awards if such approval was given. Effective August 11, 2011, the amendment to prohibit future stock options or other equity awards was approved by the Board.

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At June 30, 2014, after reserving for stock options and deferred stock awards granted in prior years and adjusting for forfeitures and issuances during the year, there were 60,598 shares reserved for issuance under the Stock Plan. The Company has not awarded stock options or deferred stock under this plan in 2013 or 2014.

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, 2013 to June 30, 2014:

		Options		Weighted average exercise price per share	Weighted average remaining contractual term
Outstanding	December 31, 2013	309,439	$	11.66	4.13
Awarded		300,246		12.27	
Exercised		(12,000)		8.28	
Forfeited		(70,563)		13.15	
Outstanding	June 30, 2014	527,122		11.88	5.57
Excercisable at June 30, 2014		208,135	$	11.88	3.49
Expected to vest June 30, 2014		527,122		11.88	5.57

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, 2014 was $312,000. The intrinsic value of all options exercised during the six months ended June 30, 2014 was $40,000. Net cash proceeds from the exercise of all stock options were $99,000 and $110,000 for the six months ended June 30, 2014 and 2013, respectively.

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, 2013 to June 30, 2014:

		Shares		Weighted Average Grant Date Fair Value
Outstanding	December 31, 2013	200,140	$	11.47
Granted		48,824		12.52
Vested		(11,754)		14.97
Forfeited		(8,842)		10.82
Outstanding	June 30, 2014	228,368		11.54

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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, 2013 to June 30, 2014:

	Shares	Weighted Average Grant Date Fair Value
Outstanding December 31, 2013	53,193	$ 10.44
Granted	10,681	11.70
Vested	25,879	10.82
Forfeited		
Outstanding June 30, 2014	89,753	10.53

Compensation Expense

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. Share-based compensation expense recognized for the six-month period ended June 30, 2013 was $ (51,000) before income taxes and $ (33,000) after income taxes. Unrecognized compensation expense for the Company s plans was $1,176,000 at June 30, 2014 and is expected to be recognized over a weighted-average period of 2.9 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, 2014 and 2013 were $75,000 and $14,000, 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 2014	December 31 2013
Finished goods	$ 20,173,233	$ 18,733,636
Raw and processed materials	10,906,877	10,378,020
	$ 31,080,110	$ 29,111,656

NOTE 5 INTANGIBLE ASSETS

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

	June 30, 2014			
	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net
Trademarks	81,785	(35,424)	3,353	49,714
Customer relationships	490,707	(148,922)	20,121	361,906
Technology	228,996	(138,863)	9,390	99,523
	801,488	(323,209)	32,864	511,143

	December 31, 2013			
	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net
Trademarks	81,785	(17,262)	(10,545)	53,978
Customer relationships	490,707	(72,500)	(43,105)	375,102
Technology	228,996	(67,667)	(42,066)	119,263
	801,488	(157,429)	(95,716)	548,343

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Amortization expense on these identifiable intangible assets was $54,000 and $50,000 in 2014 and 2013, respectively. The amortization expense is included in selling, general and administrative expenses.

NOTE 6 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, 2014 and 2013, respectively, the majority of which relates to a five-year obligation to provide for potential future liabilities for network equipment sales.

	2014	2013
Beginning balance	$ 564,000	$ 590,000
Amounts charged to expense	(10,000)	149,000
Actual warranty costs paid	(60,000)	(147,000)
Ending balance	$ 494,000	$ 592,000

NOTE 7 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 8 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.

At June 30, 2014 there was $243,000 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 2010-2012 remain open to examination by the Internal Revenue Service and the years 2009-2012 remain open to examination by various state tax departments. During the second quarter, the IRS completed an examination of our 2011 federal income tax return. There were no material changes to the return as filed. The tax years from 2010-2012 remain open in Costa Rica.

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The Company s effective income tax rate was 35.5% for the first six months of 2014. The effective tax rate differs from the federal tax rate of 35% 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. The effect of the foreign operations is an overall rate increase of approximately 3.5% for the six months ended June 30, 2014. There were no additional uncertain tax positions identified in the first six months of 2014. The Company s effective income tax rate for the six months ended June 30, 2013 was 36.4%, 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, and the effect of operations conducted in lower foreign tax rate jurisdictions.

NOTE 9 SEGMENT INFORMATION

Effective January 1, 2014, the Company realigned the financial reporting for its business units. As a result of this realignment, all corporate general and administrative expenses that were previously categorized as Other are now included within the three business units as fully allocated costs. The Company classifies its businesses into three segments as follows:

Suttle manufactures and markets copper and fiber connectivity systems, enclosure systems, xDSL filters and splitters, and active technologies for voice, data and video communications;

Transition Networks manufactures network interface devices (NIDs), media converters, 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. There are no material inter-segment revenues. In order to conform to the 2014 presentation, the Company has reclassified the previously non-allocated Corporate expenses within the business segments.

Information concerning the Company s continuing operations in the various segments for the three and six-month periods ended June 30, 2014 and 2013 is as follows:

	Suttle	Transition Networks	JDL Technologies	Other	Total
Three Months Ended June 30, 2014					
Sales	$ 19,006,243	$ 11,567,320	$ 2,635,414	$	$ 33,208,977
Cost of sales	12,731,061	6,181,697	2,202,451		21,115,209
Gross profit	6,275,182	5,385,623	432,963		12,093,768
Selling, general and administrative expenses	3,358,171	5,609,011	721,065		9,688,247
Operating income (loss)	$ 2,917,011	$ (223,388)	$ (288,102)	$	$ 2,405,521
Depreciation and amortization	$ 314,797	$ 230,704	$ 37,149	$	$ 582,650
Capital expenditures	$ 1,294,590	$ 251,444	$ 8,260	$ 117,536	$ 1,671,830
Assets	$ 38,303,760	$ 27,507,378	$ 3,519,924	$ 34,467,640	$ 103,798,702

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	Suttle	Transition Networks	JDL Technologies	Other	Total
Three Months Ended June 30, 2013					
Sales	$ 13,852,329	$ 10,461,771	$ 7,622,502	$	$ 31,936,602
Cost of sales	9,990,159	4,786,724	5,631,402		20,408,285
Gross profit	3,862,170	5,675,047	1,991,100		11,528,317
Selling, general and administrative expenses	2,726,835	5,571,975	662,657		8,961,467
Operating income (loss)	$ 1,135,335	$ 103,072	$ 1,328,443	$	$ 2,566,850
Depreciation and amortization	$ 275,969	$ 249,211	$ 47,681	$	$ 572,861
Capital expenditures	$ 274,380	$ 369,621	$	$ 183,451	$ 827,452
Assets	$ 27,557,698	$ 32,332,555	$ 18,835,913	$ 31,285,653	$ 110,011,819

	Suttle	Transition Networks	JDL Technologies	Other	Total
Six Months Ended June 30, 2014					
Sales	$ 31,888,574	$ 21,316,701	$ 5,202,108	$	$ 58,407,383
Cost of sales	22,123,196	11,224,667	3,977,735		37,325,598
Gross profit	9,765,378	10,092,034	1,224,373		21,081,785
Selling, general and administrative expenses	6,495,819	10,788,770	1,405,769		18,690,358
Restructuring expense		237,838			237,838
Operating income (loss)	$ 3,269,559	$ (934,574)	$ (181,396)	$	$ 2,153,589
Depreciation and amortization	$ 607,968	$ 461,418	$ 73,886	$	$ 1,143,272
Capital expenditures	$ 1,921,501	$ 358,857	$ 18,016	$ 197,089	$ 2,495,463

	Suttle	Transition Networks	JDL Technologies	Other	Total
Six Months Ended June 30, 2013					
Sales	$ 26,264,517	$ 21,274,892	$ 11,849,924	$	$ 59,389,333
Cost of sales	19,086,842	9,879,015	9,119,232		38,085,089
Gross profit	7,177,675	11,395,877	2,730,692		21,304,244
Selling, general and administrative expenses	5,355,078	11,616,634	1,394,904		18,366,616
Operating income (loss)	$ 1,822,597	$ (220,757)	$ 1,335,788	$	$ 2,937,628
Depreciation and amortization	$ 519,322	$ 460,165	$ 79,167	$	$ 1,058,654
Capital expenditures	$ 438,782	$ 500,975	$ 15,361	$ 351,463	$ 1,306,581

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NOTE 10 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 cost of the pension plans for the three-months and six-months ended June 30, 2014 and 2013 were:

	Three Months Ended June 30		Six Months Ended June 30	
	2014	**2013**	**2014**	**2013**
Service cost	$ 2,000	$ 64,000	$ 3,000	$ 129,000
Interest cost	40,000	58,000	79,000	115,000
Expected return on assets	(52,000)	(61,000)	(101,000)	(123,000)
Net periodic pension (benefit) cost	$ (10,000)	$ 61,000	$ (19,000)	$ 121,000

NOTE 11 NET INCOME PER SHARE

Basic net income per common share is based on the weighted average number of common shares outstanding during each year. Diluted net income per common share takes into effect the dilutive effect of potential common shares outstanding. The Company s only potential common shares outstanding are stock options and shares associated with the long-term incentive compensation plans, which resulted in a dilutive effect of 23,118 and 23,297 shares for the three and six-months ended 2014, respectively. The dilutive effect of stock options for the three and six-month periods ended June 30, 2013 was 3,596 shares and 6,132 shares, respectively. The Company calculates the dilutive effect of outstanding options using the treasury stock method. Options totaling 202,897 were excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2014 because the exercise price was greater than the average market price of common stock during the period and deferred stock awards totaling 171,544 shares were not included for the three and six month period ended June 30, 2014 because of unmet performance conditions. Options totaling 106,746 were excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2013 because the exercise price was greater than the average market price of common stock during the period and deferred stock awards totaling 273,571 shares were not included for the three and six month period ended June 30, 2013 because of unmet performance conditions.

NOTE 12 FAIR VALUE MEASUREMENTS

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

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

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

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

Financial assets and liabilities measured at fair value as of June 30, 2014 and December 31, 2013, are summarized below:

	June 30, 2014			
	Level 1	**Level 2**	**Level 3**	**Total Fair Value**
Cash equivalents:				
Money Market funds	$ 5,198,202	$	$	$ 5,198,202
Certificates of deposit				
Subtotal	5,198,202			5,198,202
Short-term investments:				
Certificates of deposit		2,881,947		2,881,947
Corporate Notes/Bonds		2,994,604		2,994,604
Subtotal		5,876,551		