

About Communications Systems, Inc.

Communications Systems, Inc. (AMEX:JCS) provides a growing family of physical and electronic connectivity infrastructure and services for voice, data and video communications. The company's product families include a broad range of copper-based and fiber optic connection devices, digital subscriber line filters and connection devices, structured wiring systems that support Local Area Networks, media conversion devices and switches.

FINANCIAL HIGHLIGHTS

(in thousands except per share amounts)

	2006	2005	2004
Sales from Continuing Operations	\$ 115,440	\$ 115,382	\$ 108,555
Gross Margin from Continuing Operations	38,587	37,521	35,608
Operating Income from Continuing Operations	5,025	5,870	7,629
Income from Continuing Operations	4,495	4,590	4,931
Net Income	4,495	4,470	4,763
Basic Net Income (Loss) per Share:			
Continuing Operations	\$.52	\$.53	\$.60
Discontinued Operations		(.01)	(.02)
	\$.52	\$.52	\$.58
Diluted Net Income (Loss) per Share:			
Continuing Operations	\$.51	\$.52	\$.59
Discontinued Operations		(.01)	(.02)
	\$.51	\$.51	\$.57
Average Dilutive Shares Outstanding	8,807	8,716	8,263
Working Capital	\$ 69,046	\$ 67,048	\$ 63,975
Total Assets	92,723	92,883	89,481
Stockholders' Equity	82,545	79,851	77,051

Forward Looking Statements

From time to time, in this report and otherwise, the Company makes "forward looking statements" concerning possible or anticipated future financial performance, business activities, plans, and resolution of pending claims, investigations or litigation, which are typically preceded by the words "believes", "expects", "anticipates", "intends" or similar expressions. For such 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 such forward looking statements are subject to risks and uncertainties which could cause actual performance, activities, anticipated results, outcomes or plans to differ significantly from those indicated in the forward-looking statements, including those risks and uncertainties described under Items 1A and 7 of the enclosed Annual Report on Form 10-K.



To Our Shareholders

2006 IN REVIEW

Communications Systems, Inc. (CSI) and its four wholly owned subsidiaries were off to a good start in 2006. The management staff and employees were full of enthusiasm and optimism. We were of course then disappointed in early April when JDL Technologies was notified it was being investigated by the Department of Justice in connection with funding requests for work performed for the U.S. Virgin Islands Department of Education (VIDOE) under the federal government's E-Rate Program, but our response to this unexpected development was swift and positive. CSI immediately agreed to fully cooperate on a voluntary basis with the investigation and has continued to do so right up until today. In addition, management launched its own thorough review and our Audit Committee conducted its own review of certain issues. While this investigation created additional challenges in 2006 and affected our ability to make timely filings with the SEC, we are pleased to report that as we go to print no claim has been asserted against JDL during the course of the investigation, and based on our review of our dealings with VIDOE and the E-Rate Program we believe this matter will be resolved without material cost to the Company.

As 2006 unfolded we also evaluated our approach to recognizing revenues related to JDL's work for VIDOE, as well as certain accounting shortcomings at JDL. While dealing with these matters consumed the balance of 2006 and early 2007 and also caused us to delay filing our 2006 Form 10Q and Form 10K Reports, these issues have now been addressed, as is further discussed below and in greater detail in the Form 10K report that follows. In addition, with the revenue recognition issue resolved, we have made all necessary SEC filings for 2006 and expect to be restored to good standing with the American Stock Exchange by early June 2007.

Over the past year developments affecting JDL have not distracted the Company from building long term shareholder value. The Company has stayed focused on continuing our position as a force in developing products for the next-generation networks in all four subsidiaries.

STRONG FINANCIAL POSITION

CSI continues to generate cash, closing the year with a balance of \$28,750,000 and the current ratio continues at a lofty 8 to 1. Stockholders' equity at December 31, 2006 was \$82,545,000.

RESULTS OF OPERATIONS

Sales from continuing operations were \$115,440,000 in 2006, which was consistent with sales of \$115,382,000 in 2005. Operating income from continuing operations declined 14% to \$5,025,000 from \$5,870,000 in 2005. Income from continuing operations before income taxes declined 9% to \$5,723,000 from \$6,318,000 in 2005. Income from continuing operations declined 2% to \$4,495,000 in 2006 compared to \$4,590,000 in 2005. The Company sold the operations of Image Systems, Inc. in October 2005. Those operations had a net of income tax loss of \$343,000 in 2005. The Company

recorded an after-tax gain on the sale of the operations of \$222,000. Our income tax rate for both 2006 and 2005 was lower than the expected rate due to favorable results of an Internal Revenue Service examination in the fourth quarter of 2005 for the year ended December 31, 2002 and reduced estimates of exposure to certain other state and foreign tax liabilities. Income from continuing operations per diluted share was \$.51 in 2006 and \$.52 in 2005.

AUSTIN TAYLOR REBOUNDS TO PROFITABILITY

The Austin Taylor management team and employees during the last half of 2005 and early 2006 worked hard to become profitable. It became profitable in 2006 and the optimism of its management staff and employees bodes well for continuing profitability in the future. For that reason and the fact that the pension plans at Austin Taylor were a negative factor with prospective buyers, the company ceased negotiations with all prospective buyers. The operations and assets of the Company's wholly owned subsidiary, Austin Taylor Communications Ltd., which were previously classified and reported as discontinued operations in 2005 were reclassified in continuing operations in 2006.

JDL

2006 was a very difficult year for JDL and CSI as much time, money and efforts were focused on the issues related to the Internet and wide area network services we provide to the U. S. Virgin Island Department of Education (VIDE) and the investigation by the Department of Justice (DOJ). JDL recorded all the expenses related to providing these services to VIDE but was unable to recognize \$2,555,000 of revenue to offset these expenses because of uncertainties regarding approval from the E-Rate Program in 2006. In April and May of 2007, JDL did receive approval in the form of the Funding Commitment Decision Letters from the E-Rate Program which will allow JDL to recognize the \$2,555,000 revenue in the second quarter of 2007. JDL also incurred \$400,000 of additional legal, audit and Board of Director expenses as a result of the investigation. These items contributed to JDL having an operating loss for 2006 of \$3,200,000. As we look forward to the rest of 2007 and beyond, we believe the issues related to revenue recognition and the DOJ investigation are largely behind us and JDL will again be a positive contributor to CSI's profitability.

SUTTLE

The Suttle strategic plan remained on course in 2006 as we pivoted our product mix and solutions from the traditional products to the SOHO (Small Office Home Office) and structured cabling products meeting the needs of the modern day service provider. As service providers continue to evolve from a single service model (Voice or Cable) to a comprehensive communications provider, Suttle is well positioned to deliver the required products. During 2006 Suttle has been successful in positioning our products as the standard in the Fiber to the Home (FTTH) builds within 3 of the 4 major Telco's. In addition to our success in the major Telco's, we have been successful in penetrating the Multi-System Operator market (a Multi-System Operator is an operator of multiple cable television systems) with the same product offerings, including the SOHO and structured cabling solutions. At the same time in 2006, Suttle managed its traditional, CorroShield and DSL product lines to maximize these sales in a maturing and declining market.

TRANSITION NETWORKS

2006 was truly a year of "transition" for Transition Networks. In the last half of 2005 we began the

process of merging MiLAN Technologies into one company under the Transition Networks structure. The yield was immediate and fruitful. Revenues and profits were strong in 2006. The addition of the MiLAN brand of switches, combining customer bases with Transition's strong delivery channel and number one position in the conversion market was and continues to be a great mix. 2006 also saw the addition of Chinese sourcing to the base Transition product line and laid the foundation for CSI to begin an R&D effort in Shanghai in 2007. Together with USA based "just in time" manufacturing partners and long term developing relationships with overseas suppliers, Transition and the MiLAN brand of switching products are positioned for growth in the coming years.

CHINA FACILITY

In the last half of 2006 CSI began the process of establishing a presence in China. Our new facility, located in Shanghai, China, will have its Grand Opening in June 2007 and will initially serve as a development center for Transition Networks. The Transition development center will be staffed with a managing director from our headquarters staff and experienced local software and hardware engineering resources that will increase the available number of new products and decrease the time to market. As the need arises, the other business units will also locate people at this facility.

LONG-TERM INVESTORS REWARDED

Shareholders who have been long-term holders of CSI were again rewarded by their commitment to long term growth. In November of 2006, Hector Communication Corporation was sold for \$36.40 per share in cash. Hector Communication Corporation was spun off to CSI shareholders in 1990. CSI shareholders received 1 share of HCC for each 2 shares of CSI owned at that time. That spin-off was preceded by the spin-off in 1986 of North American Communications Corporation whereby shareholders of CSI received 1 share of NACC for each 2 shares of CSI. NACC was sold in 1988 for \$29.10 per share in cash. If you purchased 100 shares of CSI in our initial public offering in 1981 and maintained your investment in our stock and the spun-off companies, today you own 450 shares of CSI and you have received a total of \$9,631 in cash dividends and cash proceeds from the sales of HCC and NACC.

POSITIVE OUTLOOK FOR 2007

Overall we made solid progress during 2006 despite the challenges related to the JDL investigation and revenue recognition issues. As we look to build on the solid foundation we have established, we will continue to position ourselves to meet our customers' needs, drive profitable growth and create long-term shareowner value. We will also maintain the highest standards of corporate governance and business ethics. Perseverance under adverse conditions is one of the characteristics of good management. Thank you to all our employees for your support and actions.

We also thank you our shareowners for the continued trust you have placed in us.

Sincerely,



OFFICERS

Curtis A. Sampson*Chairman and Chief Executive Officer
Jeffrey K. Berg*President and Chief Operating Officer
Paul N. Hanson*Chief Financial Officer, Vice President of Finance,
Treasurer and Secretary
Daniel G. EasterPresident and General Manager, Transition Networks, Inc.
Thomas J. LappingPresident, JDL Technologies, Inc.
Michael J. SkuciusChief Operating Officer, JDL Technologies, Inc.
David T. McGrawPresident and General Manager, Suttle
Michael GriffithCo-Managing Director & Finance Director, Austin Taylor
Paul GaskellCo-Managing Director & Sales Director, Austin Taylor
Charles A. BraunController
Karen J. Nesburg BleickDirector of Human Resources

**Corporate Officer*

BOARD OF DIRECTORS

Curtis A. SampsonChairman and Chief Executive Officer
Paul J. AndersonPrivate Investor
Edwin C. FreemanVice President and General Manager, Bro-Tex, Inc.
Luella Gross GoldbergDirector of several corporations
Gerald D. PintRetired Vice President, Telecom Systems, Group, 3M
Company
Randall D. SampsonPresident and Chief Executive Officer, Canterbury Park
Holding Corporation
Wayne E. SampsonPrivate Investor

A SPECIAL THANK YOU!

Wayne E. Sampson (brother of Curtis A. Sampson, founder of Communications Systems, Inc.) has decided to resign from the Board effective June 21, 2007. Wayne's 53 years of experience as a financial executive have been very beneficial to CSI. We are all very grateful to Wayne for his enormous contributions to the Company over the 26 years he has served on the CSI Board of Directors. In the future, Wayne may continue to serve on the Company's Finance Committee on a consulting basis. The Board expects to name a replacement following the shareholders meeting.



We wish Wayne well as he devotes more time to his family and his many interests.

CORPORATE INFORMATION

Corporate Headquarters

Communications Systems, Inc.
213 South Main Street
Hector, Minnesota 55342
320-848-6231

Transfer Agent and Registrar

Wells Fargo Bank, N.A.
South St. Paul, Minnesota

Independent Auditor

Deloitte & Touche LLP
Minneapolis, Minnesota

Corporate Council

Lindquist & Vennum P.L.L.P.
Minneapolis, Minnesota

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 & Exchange Commission website.

COMMON STOCK INFORMATION

The Company's common stock is traded on the American Stock Exchange ("AMEX") under the trading symbol JCS.

The table below presents the range of high and low trading prices for the Company's stock for 2006 and 2005 as reported by AMEX.

Quarter	2006		2005	
	High	Low	High	Low
First	\$12.29	\$10.30	\$13.60	\$10.07
Second	11.54	9.34	11.79	8.65
Third	10.82	8.72	12.50	9.50
Fourth	10.70	8.65	12.40	9.48

DIVIDEND INCREASES

CSI continued its plan to increase dividends as the Board declared a cash dividend of \$.08 paid 1/1/06 and 4/1/06, \$.09 paid 7/1/06 and 10/1/06, and \$.10 paid 1/1/07. At the Board meeting held February 23, 2007 a dividend of \$.10 per share was declared for payment on 4/1/07.

CSI BUSINESS UNITS



www.austin-taylor.co.uk



www.jdltech.com



www.suttleonline.com



www.transition.com

COMMUNICATIONS SYSTEMS, INC
ANNUAL MEETING OF SHAREHOLDERS

Thursday, June 21, 2007
10:00 a.m. Central Daylight Time
Communications Systems, Inc.
6475 City West Parkway
Eden Prairie, MN

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