

**PINNACLE DATA SYSTEMS, INC.
(AMEX: PNS)**

2004 Q1 Results Conference Call

April 21, 2004

The following discussion will contain forward-looking information within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those projected in the forward-looking information due to many factors which are contained in the Management's Discussion on page 5 of our annual report to shareholders.

John Bair: Good morning. This is John Bair, CEO and President of Pinnacle Data Systems, Inc.

Thank you for joining us this morning for our 2004 first quarter investor conference call.

With me on this morning's call is Mike Sayre, our Executive Vice President and CFO.

Mike, will you please read the safe harbor statement and introduce the format for our call?

Mike Sayre:

The following discussion will contain forward-looking information within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those projected in the forward-looking information due to many factors, which are contained in the Management's Discussion on page 5 of our annual report to shareholders.

We do not intend to disseminate any material non-public information during this call.

On March 27, we completed the first fiscal quarter of 2004 and we reported our results for the quarter in a news release this morning.

John will talk a little about the nature of our business and go over some of the highlights of the quarter, followed by my review of the financial results. Then, John will wrap up with additional comments and we'll have a brief question and answer session.

John Bair:

Thanks Mike.

Before we get started, many of you probably saw the 8-K we filed on Friday concerning the resignation of David Swaddling from our board of directors. Dave was our Audit Committee Chair, so you need to know that Dave's departure had nothing to do with any disagreements on our financial reporting or our internal controls. Dave was on our Board less than a year, and unfortunately, sometimes, things just don't work out.

We have started a search for a replacement and already have four interested and viable candidates who meet the "financial expert" requirements of the SEC and the American Stock Exchange. We expect to conclude our search in the current quarter.

[PAUSE]

For those of you who may not be familiar with PDSi, I will briefly discuss what we do and our general business strategy.

PDSi's mission is to be the premier provider of high-quality, out-sourced product development, manufacturing and after-the-sale support services to computer and computer peripheral original equipment manufacturers (OEMs), as well as those OEMs who incorporate computers into their products.

We generally market to OEMs in, among others, the aerospace, computer, computer peripheral, data storage, digital-imaging, medical diagnostic, process-control, and telecommunications equipment industries.

Our services help OEMs increase product speed to market, extend product life, and provide high-quality cost-effective service and support to units in the field through comprehensive product lifecycle management programs.

Our business can be broken down into two business segments: services (with high labor content, like engineering services, depot repair and advanced exchange logistics) and products (with higher material content that are generally designed, developed and/or manufactured in-house).

Our strategy is to

1. maximize the growth in services, which generally provide recurring revenue streams and can be fairly predictable and profitable,
2. leverage resources from the services we provide and strategically invest in the development and manufacture of new products with high revenue and profit potential for customer-specific and niche industry applications, and
3. take advantage of the counter-cyclical nature of the services and products we provide to maintain financial stability and continue to generate significant growth opportunities on an on-going basis in whatever the prevailing business climate happens to be. When capital spending declines in our markets, our customers buy less products and start looking for more ways to maintain or even extend the life of what's already in the field. This can create additional opportunities for us in what may otherwise be considered a down economy.

[PAUSE]

We are very pleased with the results of the first quarter of 2004. We saw continued product strength, the resumption of an upward trend in service sales, strong margins and continuing interest in setting up new programs.

In our earnings release published this morning, we noted several highlights of the quarter, including

- The achievement of a new record for quarterly net income (the previous record was set in 2000, the most profitable year in Company history),
- Two of the Company's highest sales quarters in a row, and
- Our first agreement to be able to offer test, repair and logistics services at facilities in Europe with Kender Thijssen European Repair in The Netherlands. This agreement could lower transportation costs for both companies' customers, enhance both companies' emergency shipment capabilities, and expand the technical expertise we are both able to offer. Both companies expect to gain additional business with OEM customers who have requested such capabilities in both North America and Europe.

Also, during the quarter

- We formed a new relationship with Solid Information Technology Corp., to rapidly develop and provide PDSi hardware platforms with Solid's high availability databases for both PDSi and Solid customers who need to get their carrier-grade telecommunications applications to market ahead of their competition,
- In a Sun Microsystems news release, PDSi was named as one of Sun's partners in a campaign to market more of the services PDSi offers to telecommunications Network Equipment Providers, and

- We won a \$4 million telecommunications equipment order and shipped and billed about 10% of that order late in the first quarter. Timing for the completion of the order will depend upon parts availability, but it should all ship by mid-year.

Due to our agreement with our customer, we cannot provide further details of this order. However, this is now the largest single order received in the Company's history, surpassing the previous \$3 million record for medical diagnostic equipment we just announced last quarter. At the end of the first quarter about 75% of that order had been shipped.

Mike will now review the financial results for the quarter and I'll come back to discuss what we are working on today and where we are headed, then we'll wrap up the discussion with some Q&A. Mike?

Mike Sayre:

Thank you John.

Total sales of \$7.0 million in the first quarter of 2004 were up 69% from \$4.2 million in the same quarter of 2003.

Product sales of \$5.4 million in the first quarter improved 146% over the \$2.2 million in product sales in the first quarter of 2003. The growth in product sales actually came from a number of both current and new customers in a number of industries, buying both old and new products, as capital spending in our customers markets continues to gain strength.

Service sales for the first quarter were \$1.6 million, resuming a sequential quarter upward trend from \$1.4 million in the fourth quarter of 2003, however, representing a 17% decrease from approximately \$2.0 million for the first quarter of 2003. In the first half of 2003, the overlapping of significant in-coming and out-going H-P repair programs were producing record quarterly service sales. In addition, part of the H-P UNIX Workstation Repair program revenue that was in service sales in the first quarter of 2003 was replaced with the tape library assembly and test program revenue that now shows up in product sales in 2004.

Gross profits were \$2.3 million for the first quarter of 2004, up 84% compared to \$1.2 million for the first quarter of 2003, driven by the increased product sales.

The product volume in the first quarter of 2004 increased the product gross profit margin to 29% from 20% and total gross profit margin to 32% from 30% in the first quarter of 2003. In addition, service gross profit margins increased to 43% from 41% with less start-up and tear-down expenses in the first quarter 2004 compared to the first quarter of 2003.

The operating expenses line of our statement of operations is basically selling, general and administrative (SG&A) expenses. SG&A expenses increased to \$1.6 million for the first quarter of 2004 from \$1.1 million in the first quarter of 2003 due to increasing costs tied directly to our growth in revenues and profits and to investment required for our future growth. In the first quarter of 2004, total SG&A expenses were only 23% of sales compared to 26% in the first quarter of 2003.

Net income for the first quarter of 2004 was a quarterly record for the company at \$362,000 compared to \$75,000 for the first quarter of 2003. The prior quarterly earnings record was \$331,000 in the third quarter of 2000.

For the trailing twelve months, sales were almost \$26 million, earnings were over three quarters of a million dollars, or 13 cents per diluted share, and return on equity was approximately 19%.

The increased business has resulted in both increased receivables and inventory. For comparison purposes, in the first quarter of 2001, when we were last at these shipping levels, we had over three times as much inventory as we do today. On March 27, 2004, borrowing on the line of credit was reduced to \$1.9 million from \$2.5 million at December 31, 2003, and availability on the line was over \$3 million. We are not currently, and do not expect at this time to be constrained by our credit limits.

On the investor relations front, we are on track with our quarterly visits to potential investors in varying markets. We had meetings in Milwaukee and Chicago after our last call and will be participating in the American Electronics Association Micro Cap Conference on the west coast on May 17, speaking to a fairly large group of investors that invest in technology-

related companies like ours. More information on that investor conference is available at AeA's website at www.aeanet.org/microcap. We continue to focus on performance and are getting our story out.

John?

John Bair:

Thanks Mike.

Winning as much business as we can in this improving economy is our top priority. We have capacity at our facility to take on more work and are not currently having trouble finding the people we need to get the work done.

The real key for PDSi is leveraging our growing reputation as a highly regarded service provider to OEMs. OEMs and even other service providers are picking up the pace of outsourcing the parts of their businesses that they do not consider their core competencies, such as

- the engineering of specialized computer controllers, systems or components (like the controller we recently developed for a Fortune Global 500 copier/printer manufacturer who, in a first quarter news release, announced the new product line we are supporting),
- small-run and mature products manufacturing (like the tape library equipment we are manufacturing for H-P),
- complex multi-vendor integration (like the telecommunications order we referred to earlier),
- hardware management (like the supply and maintenance of computer systems we just started for a state-sponsored home education program), and
- after-the-sale repair and logistics services (like we been providing for the computer OEMs for years).

Our broad range of services gives us multiple avenues into new accounts and a large number of opportunities to expand the scope of products and

services we provide once we are in an account. For example, since we started working with H-P in 2001, we've performed for them electronic repair and logistics, electromechanical repair, engineering services and end-of-life manufacturing. For a telecommunications equipment provider we've been working with for about five years, we've performed product engineering and development services, small-run manufacturing, complex multi-vendor integration and repair and logistics services. There are many more examples, but we are encouraged by the fact that once these industry giants start working with us on one project, they are very receptive to our proposals to expand our relationship into others.

So, we are currently increasing the size of our sales and marketing organization with very talented "hunters" (those account executives in the field getting us into new accounts) and "gatherers" (account managers who, in addition to handling the day to day management of our client accounts, are also looking for additional opportunities for us to add value with our other services in their accounts).

We're also increasing marketing and advertising by

- placing targeted ads in industry publications such as Embedded Computer Design magazine, and
- attending more trade shows, such as the CTIA Wireless show in Atlanta in March, where we shared a booth with Sun Microsystems, and Chicago's SuperComm 2004 show in June, where we will be sharing booths with both Intel and the PCI Industrial Computers Manufacturers Group.

And, finally, we've been improving our internal infrastructure and productivity and will be hiring strategically to keep our costs in line as we continue to grow.

Earlier in this conference, I said that PDSi's mission is to be the premier provider of high-quality, out-sourced product development, manufacturing and after-the-sale support services to computer and computer peripheral OEMs, as well as those OEMs who incorporate computers into their products.

Those services are the basis of this company. However, we've also been fairly successful at leveraging potentially large revenue and large margin product opportunities off of the services we provide...the kind of opportunities that can really propel the growth of a company such as ours. That's why we feel so strongly about the long term potential of our business model.

Current bookings are expected to result in record sales and continued strong earnings for the second quarter. We expect to grow both product and service sales and be profitable year-over-year, so we are optimistic about the second half. However, we are not giving additional guidance at this time.

We are very proud of our recent accomplishments and our quarterly results. And, we are as confident as ever in our strategic direction for the future.

Thank you for joining us today. We'll now take as many questions as we have time for.

[Q&A SESSION]

John Bair:

We'd like to thank you for the time you took to be with us this morning and hope this call provided you with helpful insight into what we're doing at PDSi to increase the value of the Company for our shareholders. We appreciate your support. This concludes the conference call. Thank you.