

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

**2003 Q3 Conference Call**

**October 22, 2003**

*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 on our 2003 third 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 September 27, we completed our third thirteen-week quarter of 2003 and we reported our results for the quarter in a press release this morning.

John will talk a little about the nature of our business and go over some of the highlights of the third 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.

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

PDSi provides technical services and solutions, encompassing the development and production of embedded (built-in) computer systems and components, as well as the testing and repair of computer systems, components and peripherals. We generally market to Original Equipment Manufacturers (OEMs) in, among others, the computer, computer peripheral, data storage, medical diagnostic, digital-imaging, process-control, and telecommunications equipment industries. We offer a full range of services to increase product speed to market, extend product life, and provide service and support to units in the field through comprehensive product lifecycle management programs encompassing depot repair, advanced exchange, contact center support and end-of-life control.

Our business is comprised of two business segments; services (like depot repair and advanced exchange logistics) and products (generally designed, developed and/or manufactured in-house, like controller boards for complex medical diagnostic equipment).

Our strategy is

- to maximize the growth of the services business, which provides a recurring revenue stream, is profitable, and can be fairly predictable,
- to leverage the resources shared or provided by the services business and strategically invest in the development and manufacture of new products for customer-specific and niche industry applications, and
- to take advantage of the counter-cyclical nature of those two business units to achieve financial stability and continue to generate

significant growth opportunities on an on-going basis in whatever the prevailing business climate happens to be.

We just reported our fifth consecutive profitable quarter and we expect the current quarter also to be profitable. That means we expect to achieve a profitable 2003 year...quite an improvement over our near break-even 2002, which was quite an improvement over the losses of 2001. Our achievements are the result of a very talented and dedicated group of people executing on the business strategy I just shared with you.

We have a number of on-going and new programs and initiatives I would like to update you on today.

In the repair and logistics services segment, our expanded knowledge and experience in tape library electro-mechanical technologies is being leveraged in an engineering project started in the second quarter and continuing into the fourth quarter that could expand into additional tape library repair programs for us in the near future.

In the third quarter, we began providing services to a Fortune Global 500 aerospace company to ruggedize a very complex and expensive printed circuit board assembly to protect it from moisture condensation caused by sudden and extreme changes in environment, like altitude. This assembly ultimately ends up in military aircraft. These orders carry over into the fourth quarter and we are currently working on securing additional business from this new customer.

For the fourth quarter, we've also received what we hope will be the first of our orders to participate in a much larger and longer term program with a service provider that supplies computers and associated tracking, repair, refurbish and logistics services to a large educational program in Ohio.

In the products segment, you may remember from last quarter, we talked about a program to integrate our BlueSwitch technology into a very high-end publishing system with a Fortune Global 500 publishing equipment manufacturer. This program has been over a year in development. Shipments started ramping up in the third quarter for this multi-year program.

We are continuing to grow our relationship with Intel, a Fortune Global 500 company, and continue to receive referrals from Intel that are turning into additional business for us. In recognition of the distinct level of expertise we have developed on Intel's technologies and solutions, especially with Intel's Itanium 2 technology, we were recently awarded Intel Premier Provider status.

In addition, the agreement with Agilent (another Fortune Global 500 company) to be the North American reseller of their remote diagnostics cards and chips also started producing revenue in the third quarter with significant product sales to a global provider of data storage and management solutions. The word "reseller" is an oversimplification of the role we generally play in working with Agilent and its customers. Agilent's remote diagnostics cards and chips give our customers the capability of networking with their own products in the field to perform testing, maintenance and customer support without having to actually send a field service technician to the customer's site. That can be a huge competitive advantage for our customers. However, the Agilent cards and chips must be integrated into the customers' products. Our support includes product design, development, assembly, test and after-the-sale service.

Going into the fourth quarter, we've announced a \$1 million order for TS1000 telecommunications servers. The TS1000 was specified in a proposal made by our OEM customer to a service provider for use in their telecommunications network in Asia. Trials including the TS1000 were successful and culminated in this sizable order. We do not yet know if this will end up being an incremental sale that will put us above the revenue level of recent past quarters.

To summarize, we have a number of existing programs that have shown new signs of life, new programs that have progressed to, or are progressing towards, the revenue-producing stage and we are increasing our investment to enlarge the pipeline for new opportunities.

On that last item, we've mentioned increasing our marketing and sales expenditures in the coming months, so I'd like to discuss the services we offer in the markets we are targeting; name some examples of leaders in their industries that we are, or would like to be, doing business with; and then discuss how we plan to increase our presence in those markets. The services we offer, and the markets and some of the accounts we are targeting are

1. Repair and logistics services to electronics OEMs like Hewlett-Packard, Sun Microsystems, IBM, SGI, Cisco or Motorola,
2. Design and manufacturing services to medical OEMs like Bayer, GE Medical and Hologic, commercial imaging OEMs like Xerox and Kodak, semiconductor manufacturers like ASML, LTX and Texas Instruments, aerospace OEMS like Lockheed and British Aerospace, and telecommunications OEMs like Alcatel, Lucent and Nortel, and
3. Repair and logistics services to TPMs and other computer service providers like Northrup Grumman, Unisys, or Honeywell.

The more we have been out in these markets, the more opportunities we have been able to bring in. We believe these markets can provide significant growth over the ensuing years with a larger, but still modest, amount of investment in additional marketing and sales. Remember, almost all of our leads came from industry relationships with Sun or with Sun-related companies prior to 2001, and then we only hired three salespeople to cover the entire U.S.! It took about a year in a very rough economy to start getting trials in the door. Now we are leveraging that marketing and sales experience gained over the past two years to further penetrate these markets and accounts. Our marketing plan includes very targeted lead generation and advertising services. We are also increasing our direct sales force, our internal sales support structure, and evaluating the use of indirect sales organizations with existing relationships in large OEM accounts. We have already begun the process, upgrading our West Coast direct sales office as well as our internal program management team (which is key to getting additional business in existing large accounts). You will hear more about our progress in these areas in coming quarters.

In addition to our plans for organic growth, we are evaluating affordable acquisitions in repair and logistics services that

- are, or can be made, accretive in a short period of time,
- that bring large OEM customer relationships with potential additional business for the combined company (that neither company would get on their own at this point), and
- that bring resources, in terms of people, skill sets, processes and systems, that increase the scalability of the combined businesses.

Acquisitions would most likely be funded by some combination of debt and the issuance of additional common or preferred stock. However, we do not plan to greatly leverage the company for acquisitions.

On another note, we recently announced the 2003 Meritorious Supplier Performance Award we received from Sun Microsystems for our depot repair and logistics service programs. We were the only provider of these services to be so honored. We also won the award in 1999. This is a very important award for us for two reasons:

1. It speaks to the level of value our customers (many of whom are giants in their industries) perceive we provide when compared to their other suppliers and our competitors (many of whom are giants in their industries), and
2. Sun generally favors their top suppliers in awarding new business.

We are frequently asked about our relationship with Sun and our dependence on Sun as a customer. We believe in Sun and hope they are successful in turning their business around. In the mean time, there is a lot of old and new Sun equipment in the marketplace that will need servicing for years to come. Sun's annual sales are still in the \$11-12 billion range and they still show over \$5 billion in cash and marketable securities on their balance sheet! With large layoffs in their sales and marketing organization over the past couple of years, Sun is showing renewed interest in its channel partners. Our quoting activity and resulting new business opportunities with Sun have significantly increased for repair and logistics services and for new product and integration opportunities. Having said that, the dependence of our business on Sun over the past couple of years has significantly decreased as we have intentionally diversified our customer base with new repair programs with Hewlett-Packard and others, increased our set of service and technology capabilities, and developed Intel-based server solutions for customer-specific applications.

Mike will now review the financial results of the quarter.

Mike Sayre:

Thank you John.

Total sales were \$5.2 million for the third quarter of 2003, up 15% from \$4.5 million for the same period last year on the much stronger performance of the products segment.

Product sales were \$3.5 million for the third quarter, up 34% compared to \$2.7 million for the third quarter last year, while service sales were \$1.7 million for the third quarter, down 11% compared to \$1.9 million last year. Product sales for the quarter increased with the addition of the tape library end-of-life manufacturing program and increased shipments of telecommunications servers and medical and commercial imaging products. Service sales for the quarter declined primarily due to the discontinuance of the H-P UNIX workstation repair program.

Gross profit of \$1.5 million for the third quarter of 2003 represents a 6% decrease from the \$1.6 million gross profit posted in the third quarter of 2002.

The overall gross profit margin percentage of 29% for the third quarter declined from the third quarter of last year, when the gross profit margin percentage was 36%. The decrease was primarily driven by the decrease in higher margin service sales compared to the increase in lower margin product sales, and less profitable sales mixes within both products and services, even though 29% for the 2003 quarter is still above the 24% average of the last five years.

The gross profit margin percentage on products decreased to 28% for the third quarter of 2003 from 31% in the 2002 quarter (the average over the last five years for products has been about 20%). And on services, the

gross profit margin percentage for the third quarter decreased from to 32% in 2003 from 43% in 2002 (compared with the 35% average of the last five years). From quarter to quarter, the gross profit margin percentage on repair services may also fluctuate due to changing repair volumes on fixed price maintenance contracts for our own products.

Selling, general and administrative expenses (SG&A, including research and development) of about \$1.3 million was relatively unchanged from the third quarter of 2002. R&D expenses are less than last year due to engineering resources still being focused on new service program implementation and customer-specific development rather than on more speculative new product development.

The net financial result for the third quarter of 2003 was our fifth consecutive profitable quarter with net income of \$122,000 and earnings of over \$0.02 per diluted share compared to net income of \$195,000 and earnings of almost \$0.04 per share in the third quarter of 2002.

2003 year-to-date net income of \$376,000 compared to the \$115,000 loss over the same period of 2002 is attributable to

- A 22% increase in sales,
- A 29% increase in gross profit, and
- Only a 5% net increase in SG&A and interest expenses.

At the end of the third quarter of 2003, our line of credit borrowings were about \$1.5 million, down \$565,000 from the end of 2002, and significantly decreased from the \$2.2 million outstanding on the line at the end of the third quarter of 2002. Availability on the line was at an all-time high of about \$2.3 million at the end of September 2003, allowing us more flexibility to finance new projects and to possibly help finance small service acquisitions in the future.

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 currently working with Fahlgren Mortine in Columbus and Porter, LeVay & Rose in New York. In the coming months, we expect to add a transcript of this teleconference, an updated investor presentation and an investor fact sheet, that will be updated on a quarterly basis, to our website. John and I are also planning on quarterly visits to other cities on the east coast and in the Midwest to talk to current and prospective investors. If you know of people who would like to learn more about the company, please contact me and we will either set up a tour at our facilities, or try to set up a meeting if we are already setting up other meetings in their area. We will be in New York City the first part of next week.

And now I'll turn it back over to John for some final thoughts.

John Bair: Thanks Mike.

We are very pleased with our improvement over the last several quarters, as well as our position for the recovery in the economy. However, we know that to really increase the value of our investment and your investment in PDSi, we must continue to profitably grow the company to draw the attention of more investors, including institutional investors. At our current operating level, the size, character (product versus service), and profitability of individual programs can still have a noticeable effect on our quarterly results. In addition, we will be filling in capacity gaps with lower margin integration projects when higher margin, run-rate type business is not available to maximize the leverage you see in our 2003 year-to-date numbers compared to 2002. So, while sequential quarter-to-quarter results may not be constantly improving, we expect the overall trend in our results to be upward of a magnitude that will please our current investors and attract new ones.

And now we'll be happy to take your questions...

[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.