

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

**2003 Q4 and Year Results Conference Call**

**February 18, 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 2003 fourth quarter and year-end 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 December 31, we completed the fourth quarter and fiscal year of 2003 and we reported our results for the quarter and year 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 year, 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'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 (those with high labor content, like engineering services, depot repair and advanced exchange logistics) and products (those with higher material content that are generally designed, developed and/or manufactured in-house, like controller boards for complex medical diagnostic equipment).

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 for customer-specific and niche industry applications, and

3. take advantage of the counter-cyclical nature of the services and products we provide 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. For example, 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.

The strength of the services/product business model and our ability to formulate and execute successful strategies around it were as evident in 2003 as they were in 2002. In 2002, with depressed capital spending in technology and declining product sales, we were able to increase service sales by 66% and achieve a near-break-even year. In 2003, capital spending forecasts began to improve, resulting in product sales growth of 86% and the second most profitable year in our Company's history.

Other accomplishments in 2003 include:

- Being engaged by Agilent Technologies as its North American reseller of Remote Management Diagnostics products because of our broad engineering capabilities, and, as a result, benefiting from an almost immediate increase in revenues in 2003,
- Being awarded 2003 Intel Premier Provider status for our distinct level of expertise in Intel technologies and beginning to receive Intel referrals for product opportunities that also began translating into revenues in 2003, and
- Receiving a 2003 Sun Microsystems Supplier Award for Meritorious Performance based on the repair service levels we provide Sun, raising our status as a preferred supplier for additional

Sun programs and already resulting in increased repair work from Sun in 2004.

Also in 2003, we

- Received the largest single order in the Company's history for \$3 million of controller boards for medical diagnostic equipment, most of which, depending upon the availability of parts, we expect to ship in the first quarter of 2004,
- Obtained certification to ISO 14001, a desired supplier certification of a number of current and potential customers which validates our commitment to preserving the environment, and
- Reported profits in all four quarters, extending the string of profitable quarters to six.

Mike will now review the financial results for the quarter and year and I'll come back and talk to you about future plans.

Mike Sayre: Thank you John.

Total sales of \$7.8 million in the fourth quarter of 2003 were an all-time quarterly record and up 135% from \$3.3 million in the same quarter of 2002.

Product sales increased every quarter of the year, capped by sales of \$6.4 million in the fourth quarter, a 723% improvement over the \$776,000 in product sales in the fourth quarter of 2002. The growth in product sales actually came from a number of both old and new customers in a number of industries as capital spending forecasts in our customers markets began to increase in 2003.

Service sales for the fourth quarter were the low quarter ly total for the year at \$1.4 million, a decrease of 46% from \$2.5 million in the fourth quarter of 2002, which is still the all-time record in service sales for a quarter. Operational changes by two of the Company's largest service customers resulted in temporary decreases in repair volumes in the fourth quarter of 2003. In addition, part of the H -P UNIX Workstation Repair program revenue that was in service sales in the fourth quarter of 2002 was replaced with the tape library assembly and test program revenue that now shows up in product sales in 2003.

Sales in 2003 totaled \$22.9 million, up 46% compared with \$15.7 million in 2002, reflecting the 86% growth in product sales that John talked about. Product sales in 2003 were \$15.6 million compared to \$8.4 million in 2002, with the increase coming from a variety of different customers and industries. Service sales in 2003 remained unchanged from 2002 at \$7.3 million.

Gross profits were \$1.7 million and \$6 million for the quarter and year, respectively, compared to \$1.2 million and \$4.6 million for the comparable periods of 2002, posting increases of 36% and 31% for those respective periods, and driven by the increased product sales.

However, gross profit margins for the quarter and year decreased in 2003 to 22% and 26%, respectively, from 37% and 29% in 2002, driven by a decreases in service gross profit margin to 24% and 34% from 46% and 41%, respectively.

The decrease in service gross profit margins resulted from the start up of new programs, the sale of spare parts inventory at cost at the end of the H -P UNIX workstation repair program, some volume shifts in programs at varying margin levels and the temporary lower service volume of the

fourth quarter. In contrast, the gross profit margin on products increased to 21% for the quarter and 23% for the year compared to 8% and 19% for the respective periods of 2002.

The operating expenses line of our statement of operations is basically selling, general and administrative (SG&A) expenses, including engineering. SG&A expenses increased to \$1.5 million and \$5.1 million for the 2003 fourth quarter and year, respectively, from \$1 million and \$4.5 million in the comparable 2002 periods. A significant portion of the increase is related to our incentive compensation plans that have been put in place over the past two years in lieu of most wage increases.

The implementation of these plans was prudent; everyone in the company is in an incentive plan designed around the contribution they can make to the Company's success. In addition, our commission plans pay much higher for new business than existing business. These plans have been very successful in helping pull together our team and rewarding them for returning us to a path of growth and profitability. We've also upgraded some of our management staffing and support infrastructure to better handle our growing business and experienced various cost increases in areas such as facilities during the year.

The bottom line has been a sustained return to profitability for six straight quarters. 2003 was the Company's second most profitable year in history; the most profitable being 2000 just before the economy slowed down in 2001. Net income for the 2003 year was \$473,000 (\$0.08 per diluted share) compared to a near-break-even loss of \$19,000 in 2002, and, going back to 2001, a loss of \$690,000 (\$0.13 per share) on roughly the same sales as 2003. That is over a \$1.1 million turnaround on the net income line over the last two years! With the improvement in the economy in

2003, the Company has resumed a path of growth that it expects will provide a strong return to its shareholders over the long term.

At the end of 2003, our line of credit borrowings were about \$2.5 million, about half of the available credit under our line that we expanded to \$5 million from \$4 million in the fourth quarter. 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 New York after our last call and will be in the Chicago/Milwaukee area next week meeting with additional investors and fund managers interested in knowing more about our company. We are also participating in the American Electronics Association Micro Cap Conference on the west coast in May and will be speaking to a fairly large group of investors that invest in technology-related companies like ours there. More information on that investor conference is available at AeA's website at [www.aeanet.org/microcap](http://www.aeanet.org/microcap). We continue to focus on performance and are getting our story out.

John, would you like to make some closing comments?

John Bair:

Thanks Mike.

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 original equipment manufacturers (OEMs), as well as those OEMs who incorporate computers into their products.

Those services are the basis for the 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.

Towards achieving that growth and decreasing quarter-to-quarter volatility, we have and will be continuing our efforts to diversify and increase the number of programs and large customers we work with. We began that process early in 2001 when we hired salespeople in Massachusetts, Ohio and California, increased our sales support staff and began to work on getting more partnerships with the potential to be leveraged into additional business opportunities. I am proud to say that our efforts to date, during very challenging economic times, have been very successful. We have more than doubled the number of large Fortune Global 500 customers we service and have added Intel, Microsoft, Agilent and, recently, AMD to the list of technology partners that we work with to generate new business.

However, we have a long way to go. We plan to replicate our recent success by investing even more in marketing, sales and supporting infrastructure in 2004 than we did in 2003. Given our current strategic

plans and forecasts, we expect to grow both service and product sales and be profitable in 2004.

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.