

0101000110101010110010101010  
01010101001101010101100101010  
01010101001101010101100101010



**CSI** Communications Systems, Inc.

213 South Main Street  
Hector, Minnesota 55342-0777  
[www.commsystems.com](http://www.commsystems.com)

010011010101011001010  
0101010100110101010110010  
0101010100110101010110010

A woman in a dark green shirt is working in a server room, surrounded by racks of servers and a dense network of blue cables. In the foreground, a hand holds a glowing blue fiber optic cable with a black connector. The background is filled with server racks and a complex web of network cables. The overall scene is lit with a cool blue light, and there are faint binary code patterns (0s and 1s) overlaid on the right side of the image.

Annual Report **2003**

*CSI* Communications Systems, Inc.

## About Communications Systems, Inc. ....

“By broadening our scope through strategic acquisitions, we expect to achieve substantial increases in sales and profits.”



**Curtis A. Sampson**  
Chairman and  
Chief Executive Officer

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, and media conversion devices and switches.

CSI also provides network design, training services, general contracting of infrastructure installations, provisioning of high-speed Internet access and maintenance support of network operation centers for K-12 schools.

**Image Systems Acquisition.** The March 24, 2004 acquisition of Image Systems Corporation illustrates our commitment to expanding the breadth of our product offerings. Image Systems Corporation designs, manufactures and sells high-resolution display systems used primarily by hospitals and clinics. Each of the 33,000 devices in service are connected to or installed where products similar to those offered by CSI already exist.

**Dividend Policy.** CSI continued its dividend policy by declaring dividends of \$.04 per share payable January 1, April 1, July 1, and October 1 of 2003, and April 1, 2004.

## To Our Shareholders .....

**Growing in Profitability.** CSI recorded its second straight annual increase in net income and net income per share in 2003. We accomplished this despite ongoing challenges created by a sluggish communications industry that continued to negatively impact our Suttle operations.

Our Suttle business unit remained profitable, due in part to doing contract manufacturing for an unrelated party. By contrast, the Austin Taylor Communications operation in the U.K. posted an operating loss of \$1,565,000, or about \$.12 per share after taxes. We incurred substantial charges for severance packages in connection with the realignment of the Suttle and Austin Taylor (U.K.) operations, which included closing the Suttle Caribe plant in Puerto Rico. Sourcing products made to our specifications from Asia has impacted our United States and UK manufacturing requirements.

Cost savings remain a priority, and the Austin Taylor and Suttle operations are well positioned to increase sales and profitability. Austin Taylor's operations to date in 2004 are profitable, and Suttle has begun shipping digital subscriber line (DSL) products to a very large user.

**Financial Review.** CSI continued its dividend policy as our net income rose to \$2,717,000 or \$.33 per share, compared to \$2,337,000 or \$.28 per share in 2002. As previously mentioned, our UK business posted a loss of \$1,565,000, which includes severance costs of \$420,000 incurred in restructuring.

Our education unit experienced a 34 percent decline in revenue as profits fell from \$2,404,000 in 2002 to \$1,101,000 in 2003. Delayed E-rate projects accounted for most of the decline, and this business unit may experience losses early in 2004.



The media conversion and network switching business units achieved in sales of \$51,000,000 and profits of \$4,325,000. This is now CSI's largest business segment.

CSI has successfully reduced inventories and had cash of \$14,941,000 at December 31, 2003. This was down from the \$19,816,000 at December 31, 2002; however, we retired all of the \$7,000,000 in notes payable at December 31, 2002. Also, we paid about \$3,000,000 cash on March 24, 2004 to complete the Image Systems Corporation acquisition.

*Importance of Diversification.* CSI acquired three subsidiaries in the five-year period from 1998 and 2002. These acquisitions required approximately \$20,400,000 in cash and \$2,244,000 of stock.

These businesses produced 61.4 percent of CSI's 2003 revenues. Of them, Transition Networks, purchased in 1998, has emerged as a sales and profit leader. Several of these acquisitions, including Image Systems Corporation, sell products into very large markets, and present opportunities for capturing market share and increasing sales.

*CSI's Acquisition Strategy.* All five of CSI's business units have explored acquisitions in markets where the targeted company was failing or had a division or subsidiary with declining sales. We recently passed on a number of acquisition opportunities that have products and markets similar to what we already have or are developing.

CSI's business units tend to have extensive product offerings within their niche markets. This makes it difficult to justify acquiring competitors with same or very similar products. As such, we will continue to focus on strategic acquisitions that will enhance our core competencies and be consistent with our products and markets.

The acquisition of Image Systems Corporation, located in Eden Prairie, Minnesota, gives CSI an entrée into the medical and government markets. While Image Systems is a relatively small company, with forecasted sales in the \$6,000,000 range, it offers cost savings and operating efficiencies that will be implemented later in the year.

## 2004 Outlook

CSI's outlook for 2004 is positive, as we expect to achieve substantial increases in sales and profits. Our employees are dedicated to further improving the Company's operations, and we thank our shareholders for supporting our efforts.

## Financial Highlights

(in thousands, except per share amounts)

	2003	2002	2001
Sales	\$102,411	\$107,300	\$95,105
Gross Margin	29,462	28,552	25,503
Operating Income	4,020	3,940	812
Net Income	2,717	2,337	712
Net Income Per Share:			
Basic	0.33	0.28	0.09
Diluted	0.33	0.28	0.09
Average Common and Potential Common Shares Outstanding	8,186	8,246	8,365
Working Capital	\$57,952	\$53,122	\$51,303
Total Assets	\$79,096	\$88,758	\$88,012
Stockholders' Equity	\$70,838	\$68,871	\$67,308



### CSI Management Strategy.

A general manager will continue to direct the operations of CSI's business units, which include sales, marketing, engineering, manufacturing and appropriate on-site accounting and human resources. More detail on the Company's business units can be found on the following pages.

CSI's central staff will continue to provide upper-level service, including management oversight and direction, financial and accounting, information and communications systems, and human resources. The central staff conducts monthly reviews and also promotes and assists in arranging potential synergistic opportunities. More detail on CSI's central staff also can be found on the following pages.



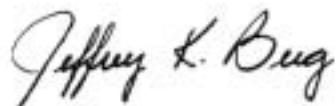
## *2003 Was Another Challenging Year For Technology Businesses* .....

Capital spending by our customers continued to decline before beginning to stabilize towards the end of the year. In spite of knowing this challenge going into 2003, CSI's outlook for 2003 was positive with sales and profits forecasted to increase. CSI was optimistic that all five business units would be profitable. We accomplished this in four of the business units. Our business unit in the UK had a very difficult year. Affecting their results were a sluggish economy, price pressures from competitors and a non-competitive manufacturing operation. During the year, we implemented major cost savings and realigned our management and sales teams in the UK. These efforts have resulted in an optimistic outlook for our UK business unit in 2004 and it is profitable to date in 2004.

In fact, we believe our efforts in all CSI's business units of expense reductions and controls, investing in our people, investing in growth segments and products and building stronger relations with our customers will lead to increased sales and profit in 2004. At this point, we have essentially completed our expense and restructuring initiatives. Our strong management teams at the corporate and business units expect in the current challenging environment that there will still be adjustments as we respond to the changing market.

CSI will continue to invest and focus on expanding our new growth media conversion and network switch segments while developing new products in our core business in the DSL and structured broadband market. CSI will also continue to evaluate businesses to identify and pursue opportunities for higher growth and profitability. We believe the acquisitions of Image Systems represents an expansion of our broadband portfolio and competencies.

*Our accomplishments in 2003 are a clear result of CSI's outstanding and dedicated employees and I thank everyone for their contribution.*



**Jeffrey K. Berg**  
*President and Chief Operating Officer  
Communications Systems, Inc.*

.....



Finance • **Brian R. Lucker**, *Corporate Controller*

Our focus in the CSI Finance Department is to help the company maximize profitability, cash flow and return on investment. We work closely with each CSI business unit to help them achieve their financial goals and objectives. Finance directs and has immediate responsibility for the organization's accounting practices, maintenance of its fiscal records and preparation of its financial reports. We direct and have overall responsibility for the general and cost accounting functions, budgetary controls, and SEC and other regulatory filings. We also support our business units with reporting and analyzing operating results in terms of costs, budgets, operations, trends and through increased profit opportunities.



Human Resources • **Karen J. Nesburg Bleick**, *Director*

The Corporate Human Resources Department at CSI is committed to supporting our divisions through comprehensive human resource services including consistent company-wide policies, competitive compensation and benefit plans, staffing assistance, training, compliance programs and many other resources. We design and maintain employee benefits programs that cost-effectively meet the diverse needs of the company's workforce. We promote a growth-oriented environment throughout all divisions. In addition, we are actively involved in planning and executing programs to support the Communications Systems, Inc. mission.



Information Services • **Michael J. Skucius**, *Director*

CSI Information Services' mission is to support our business units' decision making capabilities in three specific areas; Operational – day to day; Tactical – managing the business; and Strategic – changing the business. Our goal is to place information systems that have the greatest value in terms of creating competitive advantage, survival and prosperity of the organization. A guiding principle is that these systems also mesh with our strategic plan.

The group constantly scans the environment for information technologies, liaisons and partnering opportunities that may have application in our businesses. We establish and encourage adherence to corporate standards, manage system and communications operating costs and capabilities and allocate resources to address new business challenges.



Cautionary Statement: This annual report contains forward-looking statements concerning possible or anticipated future financial performance, business activities or plans 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 or plans to differ significantly from those indicated in the forward-looking statements. Such risks and uncertainties include, but are not limited to: lower sales to RBOC's and other major customers; competitive products and technologies; our ability to successfully reduce operating expenses at certain business units; the general health of the telecom sector; profitability of recent acquisitions; delays in new product introductions; higher than expected expense related to new sales and marketing initiatives; availability of adequate supplies of raw materials and components; fuel prices; and other factors discussed from time to time in the Company's filings with the Securities and Exchange Commission.



# SUTTLE

Suttle, based in Minnesota, manufactures and distributes telecommunications connection products and filtering devices for voice, data, and video applications in residential and commercial environments. Continued efforts in new product development and new market penetration have been successful in repositioning the company into growth markets helping offset the continuing decline of its traditional product base within the Regional Bell Operating Company customers, whose usage requirements have declined.

The realignment of Suttle's sales efforts has resulted in increased revenue with new and existing service provider customers. As telco and cable television operator network deployments continue to migrate towards enhanced services of voice, data, and video, Suttle has been successful in migrating with them, developing and supplying the appropriate filtering and structured cabling products. Additional market initiatives are also producing positive results. Suttle's Hospitality and Multi Dwelling Unit efforts have resulted in strong growth and the placement of Suttle product in prominent high-rise properties. Suttle's efforts into the international voice and data markets have also been positive with several new customer acquisitions with the voice grade products.

*Suttle finished 2003 strong and 2004's outlook will continue to build on 2003.*

David T. McGraw,  
*President and General Manager*  
.....





The economic troubles that have plagued the technology sector have been well documented in the press and are evident in the financial reports from most technology companies. Despite the macroeconomic trends in the technology industry, Transition Networks enjoyed another solid year in 2003. While we did not reach all of our goals, Transition Networks led the family of CSI companies in revenues and profits. In 2003 we experienced excellent growth in the United States, Canada, and parts of Asia, but we were negatively impacted by the sluggish economies in Japan and Europe. Transition Networks as a global company is well positioned to succeed in these markets as their economies improve and spending on technology products increases.

Transition Networks sells media converters to various market segments including enterprise businesses, service providers, government, education, retail, and manufacturing. In 2003 Transition Networks introduced several new products to further penetrate these markets as well as expand into new markets. For new product innovation we focus on customer needs, technology trends, and emerging standards. We have developed new products to offer solutions for some of the hottest growth segments in the technology market including voice over IP, wireless networks, and Gigabit Ethernet. Our media converters offer network managers creative and cost-effective solutions for implementing these new technologies.

*We have established Transition Networks as the leader in media conversion technology through high quality, excellent service, and product innovation. Our diverse market segments, wide geographic customer base, and product breadth have helped Transition Networks weather economic downturn, as well as put us in an excellent position for growth in 2004 and beyond.*

Daniel G. Easter,  
*President and General Manager*

.....



# JDL TECHNOLOGIES



JDL Technologies specializes solely in technology solutions for the vast K-12 education market and over the last 15 years has successfully delivered over \$90 million in complex local and wide area networking projects in more than 4,000 schools including the nation's largest districts such as Chicago Public Schools, Broward County Public Schools, Ft. Lauderdale, Detroit Public Schools and Baltimore City Public Schools. JDL enjoys a national reputation as one of the country's best and most respected technology corporations directed at connecting America's schools.

JDL's unique expertise has helped many of the most sophisticated school districts in the nation maximize the value they receive from their investment in information technology and broadband infrastructure. JDL has industry-leading expertise in areas ranging from the design, implementation and management of complex wired and wireless networks to IT process improvement, technology planning, funding and training. JDL's goal is to form lasting partnerships that succeed in harnessing the transformational power of IT to fundamentally improve student achievement.

Delays in government technology funding to schools prevented several projects awarded to JDL by our customers from starting on schedule in 2003. This resulted in a decline in both revenues and earnings. We are experiencing continued delays as we enter 2004; however our long-term outlook remains strong, particularly as our customers enter their new fiscal year with funding in the second half of 2004.

Thomas J. Lapping,  
*President and General Manager*

.....

## MiLAN TECHNOLOGY

MiLAN Technology, based in Sunnyvale, California, was founded in 1990 with the goal of optimizing network value. It has truly fulfilled this goal while joining with its sister companies in dominating this market space.

MiLAN focuses on supplying the best in wired and wireless network infrastructure and extension products that help companies leverage existing networks while taking advantage of new technology for growth and enhancement. Each product in MiLAN's portfolio of multi-layer networking products has been designed with value, network flexibility, reliability and growth in mind. From wireless access points and client adapters to switches, media conversion, print servers, fault tolerant transceivers and secure rack mount assemblies, all of MiLAN's networking solutions make real-world networks connect.

Since joining the CSI family, MiLAN has worked to improve its results and 2004 is the year MiLAN will have a positive impact on CSI.

Gary D. Nentwig,  
*President and General Manager*

.....





Austin Taylor Communications Ltd, located in Bethesda North Wales, United Kingdom, is a highly respected manufacturer of telecommunication products designed primarily to British standards.

Historically over half of the company's sales have been to the United Kingdom but it supplies Hong Kong, other Pacific Rim markets and the Middle East with British standard products.

Weak market economy contributed to a negative performance during 2003, with all major customers performing well below budgeted expectation.

Along with major restructuring, several major contracts were secured during the 4th quarter 2003 and contributed to a positive turnaround in January and February 2004.

Austin Taylor's supply partner in the Far East ensures that Austin Taylor is price competitive in a variety of market sectors. This combined with continued advances of the product line, AT Net Structured Cabling solutions range from a Cat 5e solution to Cat6 during 2nd quarter 2004 will support future growth and profitability.

Lee N. Ludlam,  
*Managing Director*

.....



Image Systems Corporation, the March 24, 2004 addition to the CSI family is a premier developer of next generation video graphics products.

For more than 15 years, Image Systems has served the imaging needs of its customers in the medical, military and aerospace industries. Image Systems has been known and differentiated itself with innovative products, flexible manufacturing capability and customer responsiveness.

In 2002, Image Systems developed and began manufacturing its own graphic display cards based on Field Programmable Gate Array (FPGA) technology.

Image Systems is well positioned as a key strategic acquisition because of its product development and manufacturing background.

David Sorensen,  
*President and General Manager*

.....





Paul N. Hanson  
Chief Financial Officer, Vice President of Finance,  
Treasurer and Secretary



## 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 2003 as reported by AMEX, and for 2002 as reported by NASDAQ.

Quarter	2003		2002	
	High	Low	High	Low
First	\$8.50	\$6.40	\$9.50	\$7.00
Second	8.35	6.95	8.94	6.10
Third	8.38	7.55	7.20	6.00
Fourth	8.04	6.76	8.64	5.60

Information as filed with the Securities and Exchange Commission on Form 10-K is included in the pocket of this report.

## Unaudited Quarterly Operating Results

(in thousands, except per share amounts)

2003	March 31	June 30	Sept. 30	Dec. 31
Sales	\$26,575	\$24,869	\$24,666	\$26,300
Gross Margins	7,406	7,415	6,551	8,090
Operating Income	1,184	746	562	1,528
Net Income	723	628	447	919
Basic Net Income (loss) per Share	\$.09	\$.08	\$.05	\$.11
Diluted Net Income (loss) per Share	\$.09	\$.08	\$.05	\$.11

2002	March 31	June 30	Sept. 30	Dec. 31
Sales	\$23,920	\$27,175	\$28,987	\$27,218
Gross Margins	6,377	4,635	9,152	8,388
Operating Income (loss)	651	(1,529)	2,768	2,049
Net Income (loss)	470	(1,042)	1,670	1,239
Basic Net Income (loss) per Share	\$.06	\$(.13)	\$.20	\$.15
Diluted Net Income (loss) per Share	\$.06	\$(.13)	\$.20	\$.15

## Selected Financial Information

(in thousands, except per share amounts)

Selected Income Statement Data	2003	2002	2001	2000	1999
Sales	\$102,411	\$107,300	\$95,105	\$119,720	\$117,525
Costs and Expenses:					
Cost of Sales	72,949	78,748	69,602	82,355	77,280
Selling, General & Administrative	25,442	24,612	24,691	29,432	28,907
Total Costs and Expenses	98,391	103,360	94,293	111,787	106,187
Income From Operations <sup>(1)</sup>	4,020	3,940	812	7,933	11,338
Other (expense) Income, Net	315	(45)	225	339	296
Income Before Income Taxes	4,335	3,895	1,037	8,272	11,634
Income Tax Expense	1,618	1,558	325	1,600	2,620
Net Income <sup>(1)</sup>	\$2,717	\$2,337	\$712	\$6,672	\$9,014
Net Income Per Share	\$.33	\$.28	\$.09	\$.76	\$1.04
Diluted Net Income Per Share	\$.33	\$.28	\$.09	\$.75	\$1.03
Cash Dividends Per Share	\$.16	\$.04	\$.30	\$.40	\$.40
Average Common and Potential					
Common Shares Outstanding	8,186	8,246	8,365	8,865	8,727

### Selected Balance Sheet Data

	2003	2002	2001	2000	1999
Total Assets	\$79,096	\$88,758	\$88,012	\$93,198	\$91,476
Property, Plant and Equipment, Net	5,832	7,425	8,137	10,106	10,960
Working Capital	57,952	53,122	51,303	45,486	34,787
Stockholders' Equity	70,838	68,871	67,308	71,267	66,422

<sup>(1)</sup> 2002 amounts benefited from the implementation of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets as disclosed in Note 9 of the consolidated financial statements, included in items 8.

## *Board of Directors* .....

Curtis A. Sampson	<i>Chairman and Chief Executive Officer</i>
Paul J. Anderson	<i>Private Investor</i>
Edwin C. Freeman	<i>Vice President and General Manager Bro-tex, Inc.</i>
Luella Gross Goldberg	<i>Director of several corporations</i>
Frederick M. Green	<i>President and Chief Executive Officer Ault Incorporated</i>
Gerald D. Pint	<i>Retired Vice President, Telecom Systems Group, 3M Company</i>
Randall D. Sampson	<i>President and Chief Executive Officer Canterbury Park Holding Corporation</i>
Wayne E. Sampson	<i>Private Investor</i>

## *Annual Meeting* .....

The annual meeting of shareholders will be held on Thursday, May 20, 2004 at 3:00 pm at Transition Networks, Inc., 6475 City West Parkway Eden Prairie, Minnesota.

## *Officers and Staff* .....

Curtis A. Sampson*	<i>Chairman and Chief Executive Officer</i>
Jeffrey K. Berg*	<i>President and Chief Operating Officer</i>
Paul N. Hanson*	<i>Chief Financial Officer, Vice President of Finance, Treasurer and Secretary</i>
Daniel G. Easter	<i>President and General Manager Transition Networks, Inc.</i>
Thomas J. Lapping	<i>President and General Manager, JDL Technologies, Inc.</i>
Lee N. Ludlam	<i>Managing Director, Austin Taylor Communications, Ltd.</i>
David T. McGraw	<i>President and General Manager, Suttle</i>
Gary D. Nentwig	<i>President and General Manager, MiLAN</i>
Brian R. Lucker	<i>Controller</i>
Michael J. Skucius	<i>Director of Information Services</i>
Karen J. Nesburg Bleick	<i>Director of Human Resources</i>

\* Corporate Officer



## Corporate Information .....

### Corporate Headquarters

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

### Transfer Agent and Registrar

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

### Independent Auditor

Deloitte & Touche LLP  
Minneapolis, Minnesota

### Corporate Counsel

Lindquist & Vennum, PLLP  
Minneapolis, Minnesota

The Company maintains a website at [www.commsystems.com](http://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.

## CSI Board of Directors .....

Left to Right: John "Jack" Ortman (Director Emeritus), Randall Sampson, Curtis A. Sampson, Richard Primuth (Legal Counsel), Gerald Pint, Paul Anderson, Luella Goldberg, Edwin Freeman, Wayne Sampson, and Fred Green.

