CSI Communications Systems, Inc.

Annual Report 2004

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, and high-resolution display systems used primarily by hospitals and clinics.

FINANCIAL HIGHLIGHTS

(in thousands, except per share amounts)

	2004	2003	2002
Sales	$110,779	$102,411	$107,300
Gross Margin	36,484	29,462	28,552
Operating Income	7,364	4,020	3,940
Net Income	4,763	2,717	2,337
Net Income Per Share:			
Basic	0.58	0.33	0.28
Diluted	0.57	0.33	0.28
Average Common and Potential Common Shares Outstanding	8,263	8,186	8,246
Working Capital	$63,790	$57,952	$53,122
Total Assets	$89,481	$79,096	$88,758
Stockholders' Equity	$77,051	$70,838	$68,871

TO OUR SHAREHOLDERS

To sum up Communications Systems, Inc.'s year 2004 in a word . . . Successful. Not sensational . . . despite a 73% increase in earnings per share. Our gains were hard fought in an environment very much unlike CSI's first 19 years as a public company. While we continue to grow, we have yet to reach the levels of the pre-communications industry meltdown.

From 1981 through 2000 revenue growth was steady, diluted earnings per share reached $1.17 in 1997 and dividends were at a peak of $.40 per share in 1999. The new century found the communications industry facing "a day of reckoning." Bankruptcies became more common than successes and the established giants in our industry saw their share prices decline from $50.00 and $80.00 per share to $.50 to $2.00 or $3.00.

While our revenues topped out at $119,720,000 in 2000, our net per share declined to $.75 and the company suspended our dividend after the 7/1/01 dividend until 1/1/03. Revenues and profits bottomed out in 2001 at

Curtis A. Sampson
Chairman and
Chief Executive Officer

$95,105,000 and $.09 per share. 2002 started a recovery that has continued. Despite a $1,500,000 inventory write-off in 2002 caused primarily by the industry collapse, CSI's diversification via four acquisitions, requiring $20,400,000 of cash and $2,244,000 in stock proved to be the engine that has driven the company forward enabling CSI to remain profitable throughout the troublesome years.

The highlight of 2004 was the remarkable recovery of the Suttle Operations which, for CSI's first 30 years, provided most of the capital to build CSI and enable CSI to spin-off two valuable subsidiaries to the shareholders, including Hector Communications Corporation (AMEX: HCT).

Growth in Profitability

CSI recorded its third straight year of increases in net income and net income per share. The 2004 net income of $4,763,000 was double the 2002 results and 75% increase from the 2003 net income of $2,717,000.

Revenues gained only 8% to $110,779,000 or $8,367,000 but costs and expenses were held in check while increasing only $5,025,000 resulting in Operating Income climbing $3,344,000 to $7,364,000. Extensive sourcing of products from SE Asia by four of CSI's business units has contributed to reducing costs as well as retention of certain customers.

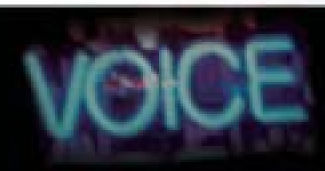
Net income per share for 2004 of $.57 easily out-paced the 2003 level of $.33, the 2002 results of $.28 and the scant $.09 per share in 2001.

Dividend Increases

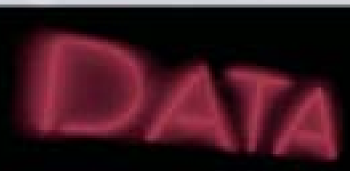
CSI continued to raise its dividends as the Board declared a cash dividend of $.04 paid 1/2/04 and 4/1/04; $.05 paid 7/1/04 and 10/1/04; and $.06 paid 1/3/05. At the Board meeting held March 3, 2005, a dividend of $.07 per share was declared for payment on 4/1/05.

Strong Financial Position

The Balance Sheet of CSI at December 31, 2004 continued to reflect the results of attentive financial management. Cash increased 73% to $25,843,000, a $10,901,000 increase. The Image Systems acquisition completed in 2004 consumed approximately $2,800,000 of cash. The current assets ratio stands at 6.1 to 1, a lofty ratio. The company has no long or short-term debt and equity of $77,051,000.



To sum up Communications Systems, Inc.'s year 2004 in a word . . . successful.



Acquisition Strategy and Product Development

CSI investigated six potential acquisitions in 2004 and one was completed. The other five didn't prove to be appropriate to consummate or were taken off the market by the sellers. Some are still under consideration but none imminent. The inability to acquire a desired product line often gives rise to expanded product development efforts. New products developed by the business units' account for a significant portion of CSI's 2004 sales and are discussed in greater detail in the following Business Unit Review.

Business Unit Review

CSI is a different company today than it was five years ago prior to the meltdown of the communication industry. We have gone primarily from a passive device manufacturer to a manufacturer and sourcing company for both passive and active devices. Our strategy over the last couple of years has been to address the demand for new products for the broadband network solutions. Our focus by business unit is to supply existing and new products to existing and new customers. We made progress in this area and the strategy and focus did pay-off in 2004.

Our Suttle business unit led the way for CSI both in revenue and profit growth. New products generated 33% of Suttle's revenue for 2004. These products included DSL filtering products and next generation network voice/data/video "triple play" products.

CSI's media conversion and network switch segments, Transition Network, and MiLAN, generated revenue of 14% and 27% respectively from new products. Our investment into gigabit Ethernet products by Transition Network and MiLAN provides exceptional value for the service providers.

While we made progress in many areas in our UK business unit, Austin Taylor, 2004 continued to bring challenges, which caused us to take difficult actions. On the positive, the trend to profitable revenue growth was generated by new customers and new products. Approximately 14% of it's sales came from these two areas.

2004 started out as a challenging year for JDL as delays in government technology funding to schools continued from 2003. JDL's efforts of controlling costs and maintaining an excellent relationship with two of their major customers resulted in a profitable year for JDL.

CSI's acquisition of Image Systems in March of 2004 brought us into a new market and new experiences. During the second quarter of 2004, price pressures from major competitors and a change from CRT displays to LCD displays created a challenge for Image System's forecast for 2004. New product revenue for the 9 months of 2004 at Image Systems was 30%.

2005 Outlook

Meeting the challenges of the future for CSI and our business units is to ensure we remain well positioned to capture new growth opportunities. We will do this by continuing to build our customer relationships, continuing to invest in products for higher bandwidth applications such as voice / data / video "triple play" and video and voice over IP (VoIP) and relying on our strong and dedicated team of people at CSI.

All of Communications Systems, Inc.'s employees would like to take this opportunity to thank our shareholders for their continued support.

Sincerely,

Curtis A. Sampson
Chairman and Chief Executive Officer

Jeffrey K. Berg
President and Chief Operating Officer

Jeffrey K. Berg

Michael J. Skucius
Director of Information Services

The Information Services (IS) Department is committed to the support of all CSI's business units by providing effective and efficient automation, information, communications and support services. The IS personnel constantly scans the environment for information technologies, liaisons and partnering opportunities that may have application in our business. In addition, IS establishes and encourages adherence to corporate standards, manages the system, and communicates capabilities and allocates resources to address new business challenges.

Karen J. Nesburg Bleick
Director of Human Resources

CSI's Corporate Human Resources department is dedicated to supporting all divisions with comprehensive human resources programs and policies. We strive toward a high level of communication between employees and managers to ensure an open work environment, a high level of productivity and to make each employee aware of their contribution to their respective divisions. CSI's competitive compensation programs and benefit packages provide for the reward and retention of our valued employees.

Brian R. Lucker
Corporate Controller

The CSI Finance Department's focus is to work closely with each CSI business unit to help them achieve financial goals and objectives. We support the financial decision making process specific to each business unit with timely reporting and analysis. Our goal is to partner with management to maximize profitability, cash flow and return on investment. In addition, we direct and have overall responsibility for the general cost accounting functions, budgetary controls, and SEC and other corporate regulatory filings.

David R. Opsahl
Executive Vice President of Corporate Development

Mr. Opsahl is the newest member of CSI's staff. His initial assignment has been a dual responsibility of Operations Manager of JDL Technologies and assisting in reviewing potential acquisitions.

Prior to joining CSI, Mr. Opsahl was engaged in a 20-year career with ADC Telecommunications Inc., in a series of executive leadership positions. His last position at ADC was Senior Vice President-Professional Services of the Software Systems Division. Previous positions include SVP-Business Unit General Manager, VP-Strategic Marketing for the Integrated Solutions Group, and Director-International Operations for ADC.

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.

David McGraw
President and General Manager

With a strong focus on growth markets and new customers, Suttle continues to find itself well positioned to deliver on its growth plans for 2005 and beyond.

In 2004, Suttle continued to grow its business due to a concentrated execution in DSL filtering products and by positioning its traditional voice products into new accounts including cable television operators. These factors contributed to Suttle being the 2004 leader in profits for the CSI family of companies.

With a strong DSL presence in the market, Suttle has turned its eyes onto the next generation network deployments. With renewed investment by service providers in networks poised to deliver the Voice / Data / Video - "Triple Play", Suttle is effectively leveraging its reputation as a trusted vendor who can service large accounts with innovative and quality products. Currently participating in multiple FTTP and VoIP deployments with its structured cabling products, Suttle is well positioned to experience continued growth with these products into large and medium sized developments.

Based in Minnesota, Suttle manufactures telecommunications connection products and filtering devices for voice, data, and video applications. In addition to domestic service provider and distribution customers, Suttle continues to see significant growth in the international market with an excellent outlook for 2005 and beyond.

Daniel G. Easter
President and General Manager

Transition Networks introduced a new 10/100/1000 media converter in 2004 and its sales exceeded all expectations.

The media converters that Transition Networks sells allow customers to migrate their network from old technology to new technology. The need for higher bandwidth is growing due to applications such as video and voice over IP (VoIP) over data networks. This is driving customers to install an increased amount of Gigabit Ethernet (1000 Mbps) in their networks. This new 10 /100 / 1000 converter allows customers to connect existing segments of their network at 10 Mbps and 100 Mbps to the new 1000 Mbps segments.

Service providers are seeking improvements to provide cost-effective and highly functional data services to their customers. IEEE 802.3ah standard opens doors for Ethernet to do just that. Secure and In-Band remotely managed optical Gigabit Ethernet media conversion, coupled with flexible connectivity, bandwidth throttling, and a wide range of monitoring, troubleshooting and reporting features provide an exceptional value for service providers.

Transition Networks is optimistic about the potential for the new 802.3ah compliant 10 /100 / 1000 converters and also about the potential of several other new products that will be launched in 2005.

Thomas J. Lapping
President and General Manager

JDL TECHNOLOGIES

Focusing on large school districts in the vast K-12 education market, JDL Technologies builds network operation centers to monitor, manage and maintain data networks and to ensure that services delivered over the network are available and reliable.

The result of network and services management is a network that delivers quality services to include Internet access, student information systems, on-line curriculum and financial accounting.

JDL has created and manages such a system for the School Board of Broward County, Ft. Lauderdale, the nation's sixth largest school system serving over 274,000 students and 30,000 employees across 270 building locations. This network connects over 110 thousand workstations and printers.

JDL also provides design and project management services for large wiring and cable plant infrastructure projects in addition to other ancillary services to include wireless solutions, voice and video distribution over the Internet Protocol. JDL offers valuable assistance to our clients with expert knowledge on eRate funding for projects and services and works through partners to provide teacher training to implement technology into the teaching practice.

Gary D. Nentwig
President and General Manager

MiLAN TECHNOLOGY

Milan Technology, is a producer of innovative and cost effective network connectivity solutions for LAN, WLAN, and Media Conversion.

MiLAN's networking solutions facilitate seamless access to information-regardless of time and place. This, in turn, leads to cost savings, process efficiencies, and closer relationships with customers, prospects, business partners, suppliers, and employees. Our products form a firm networking foundation for businesses, university and school district campuses, hotels, and government agencies worldwide. MiLAN's rich tradition of innovation continues today with a full portfolio of dynamic networking products. In FY 2004, MiLAN observed a strong growth in the following product lines:

- **Network Edge Switching: SM801x Series 8-Port L2 Management Switch**
  Targeted at vertical markets such as Education, Government,and Enterprise-Class applications. With its feature-rich software and unique 8-Port plus fiber uplink configuration, the SM801x switches enable MiLAN's customers to deploy voice/data/multi-media to thousands of locations.

- **Media Conversion: Raven & Classic Series Media Conversion Systems**
  MiLAN's media converters make it possible to mix media on a network to optimize price/performance. The Classic and Raven series MediaConversion products provide existing 10/100/1000 copper connected devices with distribution over copper or fiber to remote buildings, workgroups and desktops.

Austin Taylor Communications Ltd located in Bethesda, North Wales, United Kingdom is a well established manufacturer of telecommunications products which are supplied into numerous markets throughout the World.

The majority of products manufactured at the Bethesda facility are Metal Cabinets and Frames. The AT Net Structured Cabling range of Cat 5e and Cat 6 products are now imported from the Far East, designed to Austin Taylor's specification.

In 2004, two of the larger volume sales products manufactured in Bethesda included:

The 800 pair stainless steel Distribution Cabinet sold into Eircom in Ireland. This Roadside Telecommunications Cabinet contains double doors with heavy duty hinges and latches for security purposes. Volume sales are now well established and will continue throughout 2005.

In addition, Austin Taylor enjoyed volume sales from British Telecom who regularly purchase the High Security Aluminum 19" Swing Frame Cabinet designed to hold close circuit TV equipment. This cabinet is built to exacting high standards with special attention paid to security and internal ventilation to protect the active equipment mounted inside.

It is Austin Taylor's strategy to build upon its manufacturing base, by designing and developing added value metalwork products for developing market sectors. In addition, its expanding distributor base will be serviced with competitively priced products manufactured to Austin Taylor standards in the Far East.

Sion Thomas, Michael Griffith and Paul Gaskell
Management Team

3MP Dual-head, Front-Sensor Display System driven by Image Systems' Calibration Feedback System (CFS)

Radiologists and medical professionals need the highest quality image possible when viewing medical images generated by modalities such as CT, MRI and Digital X-ray. This "diagnostic-quality" product from Image Systems features two 3-Mega Pixel, high-contrast, flat panel displays with integrated front-of-screen luminance sensors. Image Systems has developed sophisticated calibration software (CFS) which keep the display calibrated on a "hands-free" basis to the tight requirements of the medical imaging community. New features of CFS include the ability to schedule calibration activities even when there is no user logged on, enhancing compliance to HIPPA information security requirements. The demand for this product comes from radiology clinics, large hospitals and health care provider systems, and suppliers of PACS (Picture Archival and Communications Systems) software and equipment manufacturers.

David Sorensen
Vice President of Engineering

Unaudited Quarterly Operating Results

(in thousands, except per share amounts)

2004	March 31	June 30	Sept. 30	Dec. 31
Sales	$25,249	$27,134	$29,21	$29,135
Gross Margins	7,936	9,071	9,977	9,499
Operating Income	1,115	1,603	2,504	2,141
Net Income	723	990	1,538	1,511
Basic Net Income per Share	$.09	$.12	$.19	$.18
Diluted Net Income per Share	$.09	$.12	$.19	$.17

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 per Share	$.09	$0.8	$.05	$.11
Diluted Net Income per Share	$.09	$.08	$.05	$.11

Selected Financial Information

(in thousands, except per share amounts)

Selected Income Statement Data	**2004**	2003	2002	2001	2000
Sales	$110,779	$102,411	$107,300	$95,105	$119,720
Costs and Expenses:					
Cost of Sales	74,295	72,949	78,748	69,602	82,355
Selling, General & Administrative	29,120	25,442	24,612	24,691	29,432
Total Costs and Expenses	103,415	98,391	103,360	94,293	111,787
Operating Income	7,364	4,020	3,940	812	7,933
Other Income (expense), Net	167	315	(45)	225	339
Income Before Income Taxes	7,531	4,335	3,895	1,037	8,272
Income Tax Expense	2,768	1,618	1,558	325	1,600
Net Income	$4,763	$2,717	$2,337	$712	$6,672
Basic Net Income Per Share	$.58	$.33	$.28	$.09	$.76
Diluted Net Income Per Share	$.57	$.33	$.28	$.09	$.75
Cash Dividends Per Share	$.19	$.16	$.04	$.30	$.40
Average Common and Potential Common Shares Outstanding	8,263	8,186	8,246	8,365	8,865

Selected Balance Sheet Data	2004	2003	2002	2001	2000
Total Assets	$89,481	$79,096	$88,758	$88,012	$93,198
Property, Plant and Equipment, Net	7,040	5,832	7,425	8,137	10,106
Working Capital	63,790	57,952	53,122	51,303	45,486
Stockholders' Equity	77,051	70,838	68,871	67,308	71,267

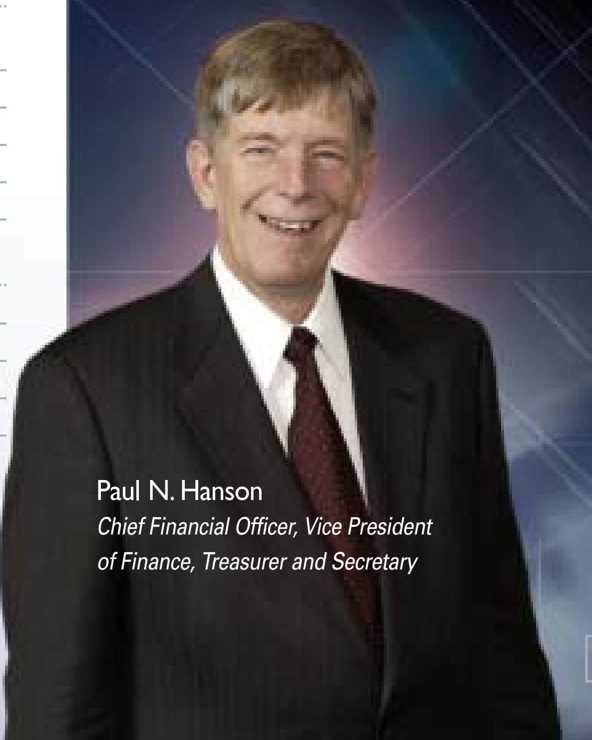
Common Stock Information

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 2004 and 2003 as reported by AMEX.

	2004		2003	
Quarter	High	Low	High	Low
First	$8.97	$7.75	$8.50	$6.40
Second	9.24	7.66	8.35	6.95
Third	8.40	7.55	8.38	7.55
Fourth	12.74	8.25	8.04	6.76

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



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

Compensation Committee
Gerald Pint, Luella G. Goldberg and Fred Green

Governance and Nominating Committee
Luella G. Goldberg, Gerald Pint and Paul Anderson

Finance Committee
Standing: Curtis Sampson, Paul Hanson, Wayne Sampson.
Seated: Randy Sampson and Edwin Freeman.

Audit Committee
Luella G. Goldberg, Edwin Freeman and Paul Anderson

Board of Directors

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

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*
David R. Opsahl*	*Executive Vice President of Corporate Development*
Daniel G. Easter	*President and General Manager Transition Networks, Inc.*
Thomas J. Lapping	*President and General Manager, JDL Technologies, Inc.*
Sion Thomas Michael Griffith Paul Gaskell	*Management Team, Austin Taylor Communications, Ltd.*
David T. McGraw	*President and General Manager, Suttle*
Gary D. Nentwig	*President and General Manager, MiLAN*
Brian R. Lucker	*Controller*
Michael J. Skucius	*Director of Information Services*
Karen J. Nesburg Bleick	*Director of Human Resources*

* Corporate Officer

CORPORATE INFORMATION

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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

Annual Meeting

The annual meeting of shareholders will be held on Tuesday, May 24, 2005 at 3:00 p.m. at the offices of Communications Systems, Inc., 6475 City West Parkway, Eden Prairie, MN.

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.

CSI Communications Systems, Inc.

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