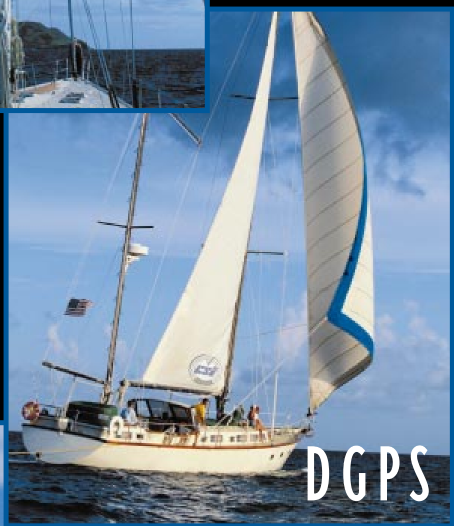
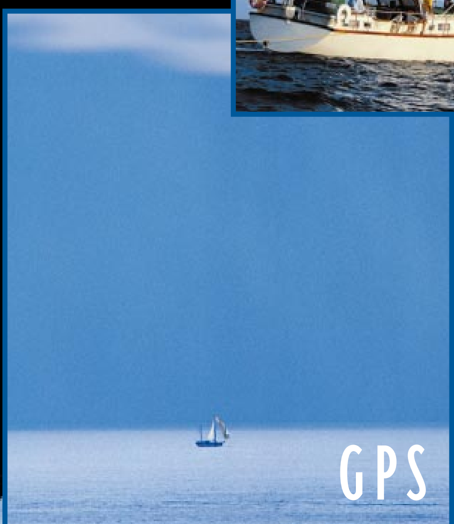
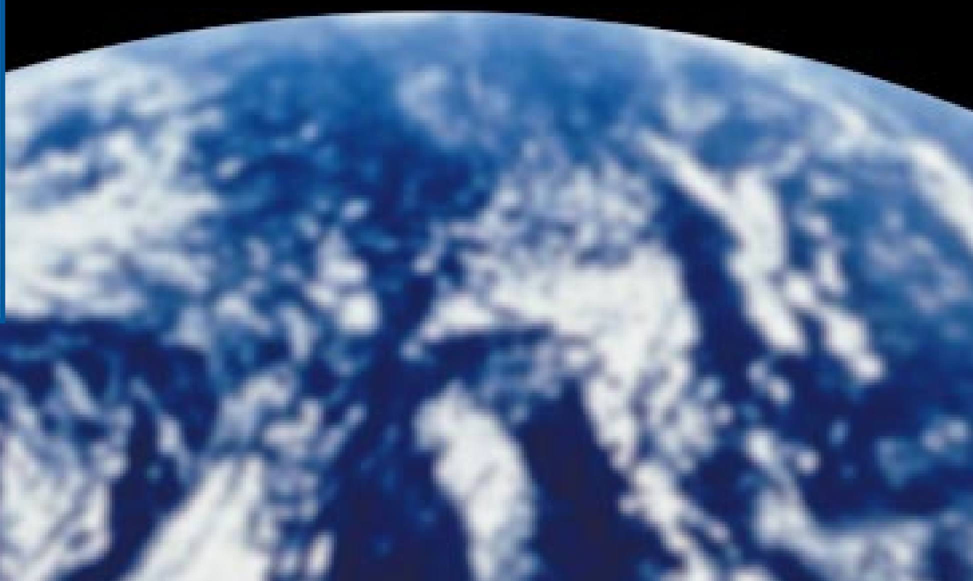
Communication Systems International Inc.

1999

Annual Report





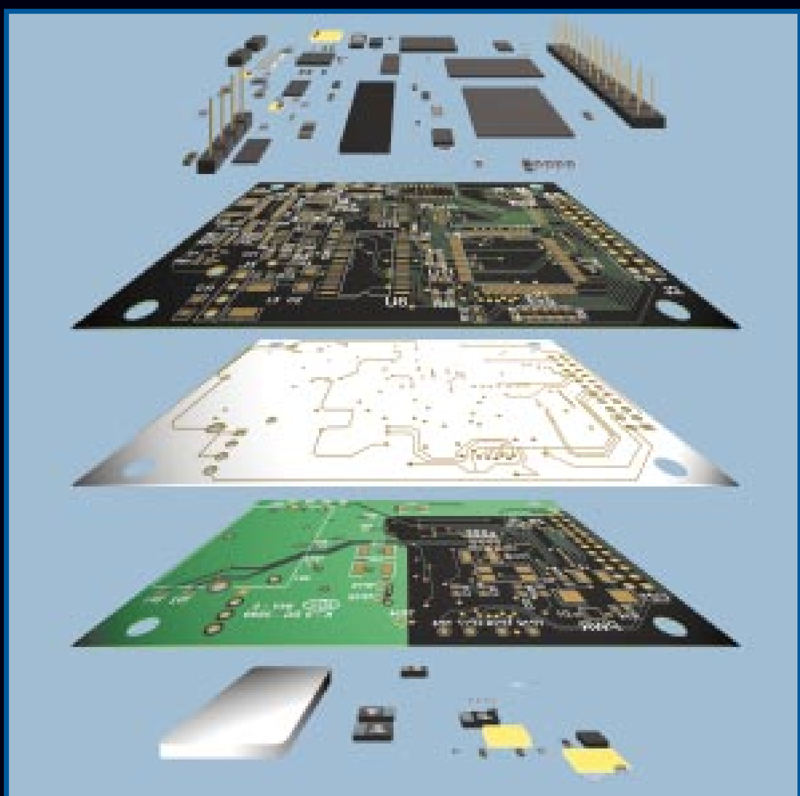


CORPORATE PROFILE

Communication Systems International Inc. (“CSI”), established in 1990, is a global leader providing low cost technology that improves the accuracy of equipment used in the Global Positioning System (GPS) from 100 meters to within 1-3 meters. Our products are employed worldwide in many DGPS applications, including marine, precision farming, geographic information systems, automatic vehicle location, hydrographic surveying, harbour management, commercial fishing and recreational uses. CSI is the leading worldwide supplier of differential beacon receivers to the GPS industry, with worldwide distribution through multi-national partners. CSI’s Arizona based subsidiary SATLOC, is a dominant global supplier of precision guidance systems using differential GPS technology and is the worldwide leader in GPS aerial swath guidance systems for agriculture and other applications.

CORPORATE MISSION STATEMENT

CSI is a world leader in Differential Global Positioning Systems dedicated to maximizing shareholder value and customer satisfaction through a commitment to quality, innovative designs and responsive customer service.



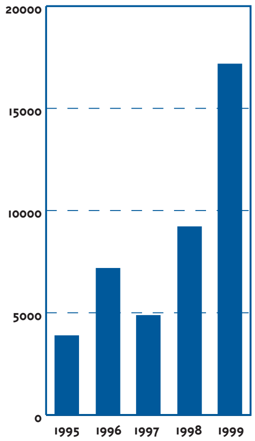
The new SBX-3 circuit board produced by Communication Systems International Inc. is approximately the size of a credit card (2”x3”) and is multi-layered.

Financial Highlights

	1999	1998	Increase
Income Statement			
Revenues	**$ 16,360,000**	$ 8,350,000	96%
Gross Margins	**$ 6,919,000**	$ 3,607,000	92%
Net Earnings	**$ 568,000**	$ 424,000	34%
Shares o/s at year-end	**6,362,375**	6,425,600	-
Earnings Per Share	**$ 0.09**	$ 0.07	28%
Balance Sheet			
Working Capital	**$ 2,637,000**	$ 2,309,000	14%
Shareholders' Equity	**$ 4,037,000**	$ 3,525,000	15%

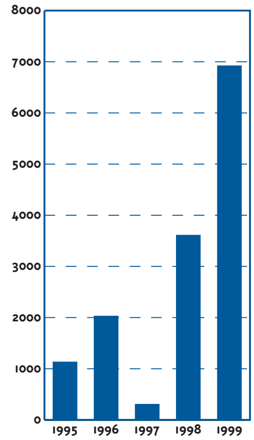
Revenue

$1,000's



Gross Margins

$1,000's



President's Message

To our valued shareholders,

It is with great pleasure that I report to you on another fantastic year! 1999 was full of successes and developments - both internally and externally. The worldwide GPS market is continuing its enormous growth rate and market forecasts are expecting growth to $15 billion by 2005. Lower costs together with increased public and commercial awareness are creating new applications that drive this growth.

CSI's key achievements and developments for 1999 include:

- Record revenues and profitability
- Acquisition of Satloc
- Record OEM volume orders
- Growth in wireless data enabled products
- US NDGPS commitment
- Release of our new SBX-3 technology
- Release of our AVL-1 antenna splitter for automotive applications

In 1999, CSI reached new levels of revenue and profitability. All four quarters reported record revenues and we finished 1999 with revenues of $16.4 million, a 96% increase over $8.4 million in 1998. Consistent profitability was an objective for 1999 and we achieved this successfully throughout the year with earnings per share increasing to $0.09 per share from $0.07 per share in 1998.

Customers use our differential GPS correction technology (DGPS) with standard GPS receivers to increase the accuracy of their position from within 100 meters to within 1-3 meters. Our corporate strategy has been to provide differential GPS technology for mass market applications. To provide such a broad-based application, we must have the best price/performance ratio in the market. With our SBX-2 technology we believe that we have been successful in implementing this strategy. Our leading SBX-2 differential receiver engine experienced high worldwide demand and OEM orders increased substantially. In October we released our next generation SBX-3 technology, making OEM integration even easier and further expanding our leadership in this area.

Stephen Verhoeff

CSI added several new customers to our impressive list of OEM partners, and are continuing to add new partners as part of our overall strategy to become the worldwide preferred supplier of differential correction receivers to manufacturers of GPS equipment.

In addition to our internal growth, revenues increased as a result of our second quarter acquisition of Satloc.

The acquisition has given us a dominant position in DGPS for the precision agriculture market. As leaders in satellite-based differential 'L-band' receiver technology, Satloc has a top position in price/performance, similar to what CSI has in beacon differential technology. As well, Satloc brought strong new members to our research and development department, rounding out what we believe is a winning engineering team, able to quickly design and develop innovative products and solutions for the growing number of applications requiring enhanced GPS accuracy. Combination GPS-satellite-beacon receivers are currently under development and promise to once again represent top performance at a low cost.

During the year we stepped up our pursuit of automotive market applications with the development of our AVL-1 antenna splitter technology, which enables differential correction signals to be received using a vehicle's standard radio antenna, without disrupting normal use for regular radio listening. Recent demonstrations of the AVL-1 have received enthusiastic reviews as it solves cost and cosmetic issues of installation. The AVL-1 is now under patent pending.

While we are pleased with our progress in 1999, the outlook for 2000 is even more exciting. GPS market growth is anticipated to accelerate. At the same time, an increased percentage of GPS applications are expected to desire or require differential accuracy. Our discussions with key players in the AVL market continue. We are pursuing wireless technology developers for joint development of an integrated GPS/DGPS/2-way wireless solution, enabling an array of new applications. The Internet also represents a key opportunity for CSI. The differential correction data that our technology utilizes can be transmitted through any digital communications medium and the Internet represents another medium for this data.

We plan to maintain our successful OEM relationship strategy to partner with all of the major GPS manufacturers and suppliers in order to become the de facto standard in differential correction technology for GPS. In this area, we have been very successful in building relationships with GPS industry leaders and we expect to add more partners in 2000.

CSI plans to continue providing new products driven by our customers' diverse requirements. We aim to expand our range of products and our ability to market these products. CSI has laid the foundation for a company that can grow dramatically as we expand into new sectors, and take advantage of the enormous opportunities in the GPS industry worldwide.

S A Verhoeff

Stephen Verhoeff
Chairman, President & CEO

Technology and Marketing

4

Expanding Market Opportunities

In 1999, CSI enjoyed the cumulative effects of expanding Global Positioning System (GPS) applications and extended implementation of the coast guard beacon system throughout the world. The most significant aspect of this was a United States government commitment to complete the Nationwide Differential Global Position System (NDGPS) project, providing coast to coast redundant beacon differential coverage in the United States. Through this expansion, CSI's products have gained renewed interest in a variety of applications.

OEM Relationships

CSI continued to have the largest market share of any Differential Global Positioning System (DGPS) provider in the high end of the marine market. Most of these sales were to large OEM's who produce colour chart plotters for navigation. In 1999, price points were established by some of the Japanese manufacturers that began to open up the lower end, recreational, marine market. In 2000, CSI's new SBX-4 board, using technology provided by GPS chip manufacturers, will result in the development of a smart antenna that contains GPS, beacon receiver and antenna in one enclosure. This will enable CSI to break into this high volume market with lower cost DGPS products, which lend themselves to e-commerce, a distribution opportunity for lower end products.

Markets

In 1999, one of CSI's fastest growth markets was Geographic Information Systems (GIS)/Survey. This growth has been the result of beacons being built in proliferation in places such as Japan, the United Kingdom, and specifically the United States. This market has grown for CSI from $75,000 per year in 1997 to a forecast of $3,000,000 in 2000. This market continues to expand for CSI as more and more applications emerge. In 1999, CSI introduced the LGBX family of products. These receivers contain a sub-meter GPS engine, a beacon receiver and an L-band receiver. While significant market share was established in 1999, the margins on these high end products were very low, due to the use of third party technology in the products. Through the acquisition of Satloc, CSI will now own all technologies in the LGBX products and margins will dramatically improve in 2000.

SBX-3

The agricultural market was CSI's third largest market in 1999, excluding revenues from the Satloc acquisition. With Satloc, agriculture is now CSI's largest current market (approximately $7,000,000 in 1999). Satloc has the majority of market share in aerial guidance for spraying applications, and this dominance will continue in 2000. The largest growth potential for this market is in the ground guidance applications. Efforts in 2000 will be focused at enhancing the current dealer network, establishing new integrators and penetrating the OEM portions of this market. Price points needed to enter the OEM side of this business has been a limiting factor in the past, but through the addition of the Satloc technology, CSI will be able to appropriately price products for this OEM market while maintaining excellent margins.

Other Market Opportunities

Automotive is one of the new emerging markets that CSI has been developing products for during 1999. This market has been emerging through several applications. While the initial mapping applications do not employ differential technology, the market is now demanding the need for higher accuracy. CSI, with its lower cost SBX-4, and the recently announced AVL-1 (antenna coupler), is well positioned to take advantage of the opportunity.

Some of the applications that are being developed in the industry include:

- Car mapping systems with turn by turn directions. This market is evolving both with the manufacturers and in the after-market. These mapping systems are sold as high-end options. Price point is the key to market entry here and in 2000 CSI, through partnering with GPS chip manfacturers, will have product priced at or near the point of entry to this market.

- Emergency Vehicle - CSI spent 1999 working with a number of research institutes on a DGPS systhat employs beacon differential combined with CSI's AVL-1 product that will alert emergency vehicles to the exact location of a vehicle when the air bags are deployed. The first proposed trials of this application should start in late 2000, with CSI products being installed in 1,200 cars.

- Crash Avoidance - In 1999, CSI began discussions with research institutes that are involved in using radar and GPS to provide crash avoidance application for the automotive industry. This work will continue through 2000. This and the above application have definite need for the accuracy provided by DGPS.

LGBX PRO

- AVL "Asset Tracking" - This application has been evolving over the past few years. CSI has won several smaller contracts for beacon differential in this market where the need for higher accuracy is defined because the application is based in an urban area and satellite differential is less effective. In 2000, though partnership with GPS chip manufacturers and the announcement of the AVL-1, CSI will have products that will compete in this rapidly growing market. In 2000, CSI will be actively pursuing business in the higher volume markets of AVL such as trucking, courier, and taxicabs.

DGPS IC Development

Throughout 1999, CSI worked with two chip manufacturers to develop lower cost integrated DGPS solutions. This technology is planned for implementation in mid 2000. These lower cost solutions will be required to meet price points needed to successfully compete in the consumer markets. Currently, CSI is talking to several companies with planned products in the hand-held markets. Hand-held applications include small puck size DGPS receivers and antenna combinations for a variety of mapping applications and palm computers to be used as golf aids.

CSI continued to aggressively target OEM business through 1999 in Marine, GIS and Agriculture markets. While Marine OEM continued to be the largest portion of CSI's OEM business, several of the year's greatest successes were recorded in the GIS markets. Changes occurred in this market in 1999 and CSI was in a very favorable position to take advantage of opportunities that developed. Continued growth in this market and development of other OEM opportunities is expected, as our technology and products evolve.

CSI will continue its teaming efforts with other industry leaders, manufacturers and integrators. This business model allows CSI to have it's technology integrated into many products and applications in a wide variety of markets. CSI's partners provide the application and the market specific expertise in this array of markets, while CSI provides the Navigation products at the core of the applications. Marine and GIS are two markets where this business plan has been very successful in the past. In 2000, partnerships are targeted in agriculture, hand-helds, GPS chips manufacturers and automotive applications.

Research and Development

CSI Engineering has developed considerably in the past twelve months. CSI recognizes that its most valuable asset as a high-technology company is its employees. With the acquisition of Satloc in June, engineering staff doubled, further adding to our technical strength and experience. With this strength, CSI can be even more dynamic and responsive to the evolving GPS industry.

GBX PRO

Some of the highlights of products developed in 1999 which have strengthened CSI's leade ship position in the differential GPS industry are:

- The SBX-3, an enhanced beacon receiver card, was introduced in September, which outperforms the already highly regarded SBX-2. This receiver has increased sensitivity providing the user with more coverage for the beacon correctors.
- The SLX, which contains a high perfor-

mance GPS chipset and an L-band satellite receiver for differential correction, has been converted to receive the OmniSTAR satellite correction service. This permits the SLX to be used almost anywhere in the world and has opened up many new markets.

- The SLX has also been made WAAS (Wide-Area Augmentation System) capable. WAAS is a free satellite correction service provided by the American aviation association, the FAA, for initial landing approaches. This service will provide a third differential corrector selection for the customer.
- Designs are being released which integrate the L-band receiver technology with the CSI beacon technology to provide a highly flexible integrated design. This design eliminates the use of third party technology in the application, resulting in higher profit margins.
- The development of a “smart lightbar” which takes the standard position input from a GPS engine and provides pilots or drivers with steering guidance. This development provides a great cost reduction to low end guidance products, permitting a significant expansion of market base.
- A colour version of the ruggedized, touchscreen, Triton personal computer has been released. This product has a shock mounted hard disk, a 586 processor and a touchscreen, providing a platform for many user applications.
- A novel antenna splitter was released in 1999, the AVL, which permits vehicles with existing AM/FM antennas to connect the beacon receiver to the existing antenna and still have the radio operate normally. This product directly simplifies many vehicle applications by eliminating the need for an additional antenna mounted on the vehicle.

Other products are under development, which will take full advantage existing and developing technologies. The primary goal over the near term is to completely merge the L-band, WAAS, GPS and Beacon technologies together to provide our customers with the best selection of differential sources from one supplier. CSI has also developing a GPS chipset to develop an integrated GPS and beacon receiver.

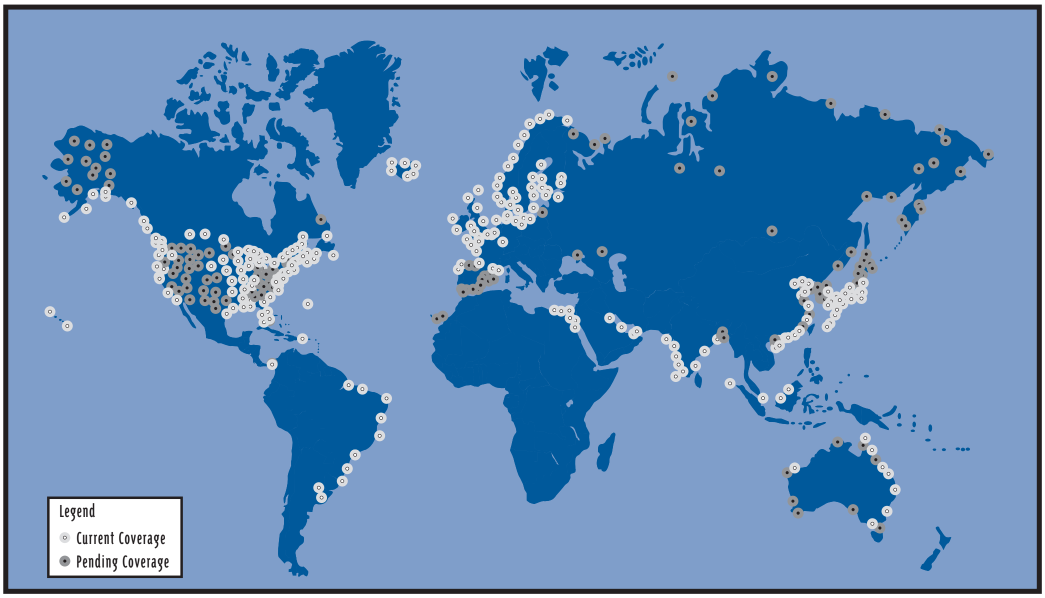
SBA-1

Other new, exciting technologies are being developed that will dramatically improve accuracy even more. CSI has positioned itself to take advantage of further developments in wireless technology, internet communication, and applying existing technology in the GPS industry.

1999 Major Achievements

- Acquired Satloc in second quarter, a leading supplier of DGPS solutions to the Precision Agriculture and GIS/Survey industries, doubling the size of CSI's annual revenues and enabling CSI to enter into new markets.
- Reported revenues of $16,400,000 in 1999, a 96% increase over revenues in 1998.
- Recorded eighth consecutive profitable quarter.
- 1999 Gross Margins increased to $6,919,000 from $3,607,000 in 1998.
- ISO 9002 certified manufacturing plant.
- Market Development - Growth in the GIS market increased from $75,000 in revenues in 1997 to $2.5 million in 1999.
- Released next generation of DGPS products based on lower priced SBX-3.

World Radiobeacon Status - September, 1999



NDGPS will be " the most accurate, most reliable, cost-effective navigation service available for civilian use and be the next great transition for our nation's navigational capabilities."

Secretary of Transportation, Rodney E. Slater, March 1999

The benefit-to-cost ratio for NDGPS is 150 to 1 "with future uses for the technology appearing almost limitless."

Senator Tina Johnson, South Dakota, Dept. of Transportation

Key Markets

Precision Agriculture **Geographic Information Systems**

Automatic Vehicle Location **Marine**

Products

SBX-3

- Mainstay of CSI's DGPS technology.
- Third generation SBX and fourth generation DGPS.
- State of the art module utilizes a digital architecture.
- Dual independent channels.
- Can extract differential information from environments with noisy radio frequency spectrum.
- Is an OEM engine.

SBA-1

- SBA-1 released during second quarter of 1999.
- Targets the Marine Navigation market.
- Combines an E-field whip antenna with an SBX-3 in a single, weather-tight compact antenna unit.
- Requires only power, data and an antenna ground for interfacing.
- Enables the everyday consumer the ability to use sophisticated beacon receiver technology.

ABX-3

- Integrates the SBX-3 within a rugged aluminum enclosure.
- Enables use in commercial applications where performance is more critical.
- Target markets are Hydrographic Surveying and Geographic Information Systems and Surveying.

MBX-3

- Flagship DGPS beacon receiver offered by CSI.
- Same overall design as ABX-3, with addition of a convenient menu system.
- Information is accessed through the menu system on a back-lit 2 line LCD.
- Target markets are Hydrographic Surveying and Geographic Information Systems and Surveying.

GBX

- Similar to MBX-3, with the addition of a GPS engine, providing a complete DGPS solution.
- Various levels of performance from an accuracy of a few meters to meter level accuracy with the GBX-PRO.
- Markets include Precision Agriculture, Hydrographic Surveying, Geographic Information Systems and Marine Navigation.

LGBX

- Addition of L-Band DGPS receiver differentiates between LGBX and GBX products.
- Allows access to OmniSTAR Worldwide DGPS service where beacons are not available.
- Markets include Precision Agriculture, Hydrographic Surveying, Geographic Information Systems and Marine Navigation.

ANTENNAS

- Various designs incorporating E-field beacon whip, H-field beacon loop, GPS and L-band antenna technology, in addition to CSI's newest AVL-1 product.
- AVL-1 allows standard vehicle AM/FM antenna to be used for both radio and DGPS beacon reception.
- AVL-1 requires a single antenna input port and two output ports - one for AM/FM and the other for the beacon receiver.

AIRSTAR 2000

- Parallel swath guidance.
- Colour touch screen with moving map.
- Windows 95 pre-loaded with MapStar.
- Satloc receiver line with L-Band and/or beacon differential.
- WAAS compatible.
- 100 waypoints/returns.

AIRSTAR 99.5

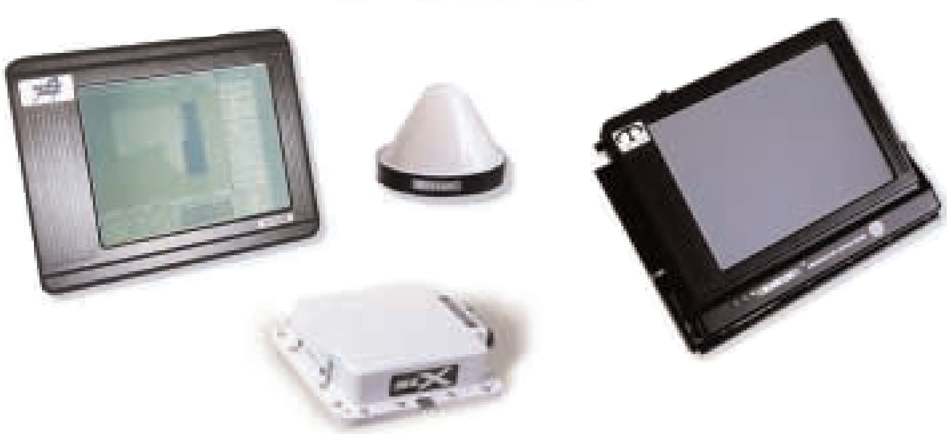
- Accurate Swath guidance.
- Satloc receiver line with L-Band and/or beacon differential.
- Full data logging.
- WAAS compatible.
- Six different patterns.

SWATHSTAR

- Contour guidance.
- Variety of applications - swath guidance, VRC applications, mapping and GIS, yield monitoring & soil sampling.
- On-the-go mapping.
- Multi-tasking.
- Touch screen offered in colour.

LITESTAR

- All in one lightbar/CPU.
- Accurate swath guidance.
- Contour swath guidance.
- Headlands feature.
- Global Satellite, Beacon and WAAS differential GPS solutions.



Management's Discussion and Analysis

The following discussion and analysis of financial condition and results should be read in conjunction with the Consolidated Financial Statements and other sections of the Company's Annual Report.

Highlights

1999 was a year of solid performance for CSI. Revenues of $16,360,000 for 1999 reflect a 96% increase over revenues of $8,350,000 for 1998. 1999 net earnings increased 34% to $568,000, or $0.09 per share, compared with earnings of $424,000, or $0.07 per share in 1998. CSI's increase in revenue was due to several factors including the acquisition of Satloc in the second quarter, increase in demand in OEM markets, and overall GPS industry growth.

In 1999, CSI's cable manufacturing division received ISO-9002 certification. In 1998, ISO-9002 certification was received for CSI's GPS manufacturing group.

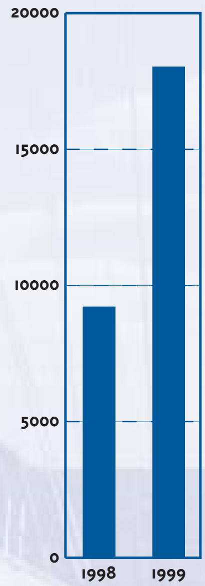
Acquisition

Effective April 4, 1999, CSI acquired certain parts of the business and assets of Satloc, based in Scottsdale, Arizona. Satloc is a dominant global supplier of precision DGPS guidance systems. Total consideration paid was $6,069,627, consisting of subordinated debt of $2,220,000, term loan of $1,499,190, and cash of $2,350,437.

For 1999, revenue from sales by Satloc accounted for 40% of total revenue, but net earnings only account for 2% of total net earnings. CSI is integrating the operations of Satloc with CSI, where possible, to reduce operating costs and increase revenues.

Revenue

$1,000's



Revenues

Revenues for the year ended December 31, 1999 were $16,360,000 for 1999 compared with $8,350,000 for 1998 and $4,405,000 for 1997. This is the second consecutive year CSI has reported increases in revenues of over 90%. For 1999, 18% of the revenue growth was due to internal growth, while 82% of the revenue growth was due to the acquisition of Satloc. The marine and agricultural markets continue to contribute strongly to CSI revenues, representing 80% of sales for 1999. Due to the mix of Satloc revenues, North American sales increased from 51% in 1998 to 55% in 1999.

Gross Margins

Gross margins increased 92% from 1998, to $6,919,000. Margins represent 42.3 % of sales for 1999, compared to 43.2% in 1998. The slight decrease in margins is due to market pressure to reduce selling prices, as the GPS industry awaits the release of CSI's next generation of technology, expected in early 2000. These consistent margins demonstrate the capability of the Company's manufacturing facilities to continue to: produce product as scheduled, as well as manage inventory to minimize obsolescence and to integrate new products into production. The Company expects to maintain similar gross margins in 2000.

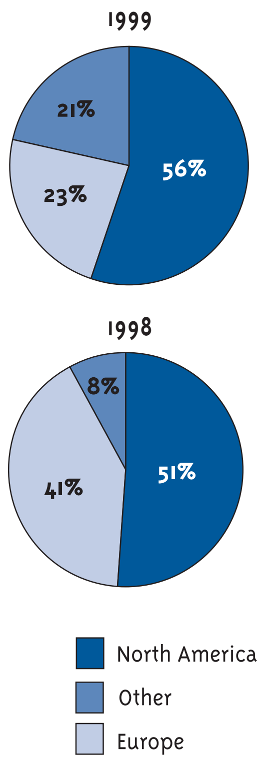
Research and Development

CSI's research and development activities focused on both the next generation of core technologies for receivers and antennas, and the combined strengths of new technologies acquired from Satloc with existing technologies.

CSI invested $1,572,000 in research and development in 1999, compared to $660,000 in 1998. Of these amounts, $311,000 and $150,000 respectively, were recorded as deferred development costs and included on the balance sheet. The Company expects research and development expenses to increase further in 2000, as we aggressively continue to develop new products and technologies to maintain our leadership in the GPS industry.

The Company applies for Scientific Research Experimental Development Investment Tax Credits ("ITC") as part of its Canadian corporate tax return, but as CSI is listed publicly, the ITC's can only be used against future taxes payable; therefore, there is no adjustment in research and development expenses is reflected.

Geographical Sales



Goodwill

1999 earnings reflected the amortization of $232,415 of goodwill compared to $6,600 in 1998. The increase resulted from goodwill amortization relating to the 1999 acquisition of Satloc.

Selling and General and Administration Expense

Selling and general and administration ("SG&A") expense increased 73% over 1998, from $2,380,000 to $4,128,000 in 1999. Of the 1999 amount, $2,028,000 is from Satloc operations, which if excluded, would have resulted in a 12% decrease in overall SG&A expenditures.

Depreciation and amortization increased significantly over 1998, from $294,000 to $711,000 in 1999. This increase is due to the amortization of goodwill relating to the Satloc acquisition, amortization of deferred development costs from prior years, and an increase in the value of capital assets depreciated. Depreciation and amortization for 2000 is expected to be consistent with 1999.

Interest

Prior to the acquisition of Satloc, CSI did not have any long-term debt and therefore no interest expense. To purchase the assets and business of Satloc, CSI entered into a Subordinated Debt with the vendor in the amount of $1,500,000 USD with an annual interest rate of 15%. As well, the Company's banker provided a Senior Loan of $1,499,190. Interest paid or accrued on these loans during the year was $251,279. The Company expects to significantly reduce the Subordinated Debt early in 2000.

Net earnings

Overall net earnings for 1999 were $568,191, or $0.09 per share, an increase in earnings of 34% over 1998 earnings of $423,674 or $0.07 per share. CSI has reported profitable earnings for eight consecutive quarters. This consistent profitability is due to efficient manufacturing operations, controlled expenses, and continued growth in revenues.

Liquidity and Capital Resources

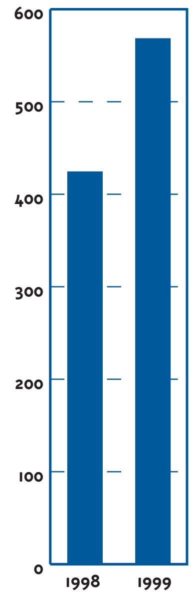
The Company had strong cash flows from operations of $1,750,000 for 1999, compared to $629,000 for 1998, but the overall cash position of the Company decreased due to working capital being used for the Satloc acquisition. At the end of 1999, cash net of bank indebtedness was $63,000, a significant decrease from $1,186,000 at the end of 1998.

CSI's working capital ratio decreased from 3.08 to 1.60 during the year, but the dollar amount of working capital increased from $2,300,000 to $2,600,000.

To date, the Company has funded its operations to date primarily through an initial public offering of equity securities, private sales of equity securities and an operating line of credit from the Company's banker. CSI announced on January 31, 2000, that it plans to proceed with a rights offering, to raise approximately $2,300,000, the proceeds of which will be used to retire debt and for general working capital purposes.

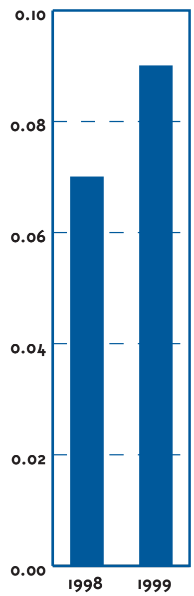
Net Earnings

$1,000's



Net Earnings

¢ per Share



The Company has an established line of credit from its bank with borrowing limits determined by trade receivables and inventory levels. Loans under this arrangement incur interest at prime plus 0.75 % to 1.25%. The Company has entered into a general security agreement with its bank to secure the indebtedness.

Inventory turnover decreased from 4.6 times in 1998 to 4.0 times in 1999. Inventory levels have increased due to longer lead times on purchases in the electronics industry and higher inventory levels required for a wider range of products manufactured. The average accounts receivable turnover decreased slightly, with turnover of 9.0 times in 1999 compared to 9.4 times for 1998.

Shareholders' equity at December 31, 1999 was $4,037,000 ($0.63 per share) compared with $3,525,000 ($0.55 per share) at December 31, 1998.

As at December 31, 1999, CSI had loss carry forwards of $1,300,000, and additional tax deductions of $1,400,000 for a total amount of $2,700,000 which may be used to reduce taxable income in future years.

The Company invested $180,000 in capital assets in 1999 versus $221,000 in 1998. Capital investments were made for research and development, and production equipment and computing technology.

The Company anticipates that the current level of working capital and available lines of credit, together with funds generated from operations and proceeds from the rights offering, will be sufficient to finance its current level of operations and financial commitments.

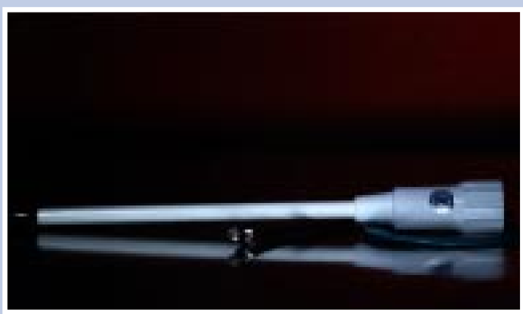
Risk Factors

The Company's future results depends on its ability to continuously develop new products as the GPS industry continues to grow and demand lower priced products with greater and improved functionality. Due to the risks inherent in transition to new products, the Company must accurately forecast demand and manage the transition from other products. The Company's results could be impacted by the ability of its competitors to introduce new products that have technological and/or pricing advantages.

CSI's products rely on signals from satellites that it does not own or operate.

Results will also be affected by the volume and mix of products, timing of orders received, fluctuation in foreign exchange rates, changing conditions in the GPS industry, and general economics of the countries in which the Company sells products. As a result, the Company's operating results may fluctuate, especially when measured on a quarterly basis.

MBA-3



Strategies for Managing Operational Risks

The Company continues to manage its operational risk by developing OEM relationships with key application developers of DGPS products in various markets. As discussed in the Marketing Section, page 4, OEM relationships have been instrumental in CSI's revenue growth and profitability. Product development for established DGPS markets, as well as for emerging markets, ensures that CSI technology continues to lead the industry.

The acquisition of Satloc provided technology that complemented existing CSI technology, and allowed for development of products with combined technologies. CSI will continue to look for other potential acquisitions that develop GPS products, and offer resultant technology advantages.

CSI will continue to invest significantly in research and development to ensure that product development meets the needs of its customers.

Financing

The Company does not have a large reserve of excess cash resources. There are competitors that supply similar products to those provided by CSI and the Company continues to compete with larger companies. CSI is also reliant upon certain key suppliers and customers, but as the Company continues to grow, this reliance is decreasing. Approximately 95% of CSI revenues are in U.S. dollars, and 30% of expenses are in Canadian dollars.

Year 2000 Issue

CSI has not experienced any product or systems failure due to year 2000 rollover issues. Also, there have not been any interruptions of supply of product by vendors, nor purchases by customers that CSI is aware of due to year 2000 rollover issues. The Company does not expect to have any future business interruptions due to these issues.

GBX

Consolidated Financial Statements

Management's Responsibility for Financial Reporting

The management of CSI is responsible for the preparation and the presentation of the consolidated financial statements and related information published in this annual report. These statements were prepared in accordance with generally accepted accounting principles in Canada.

The preparation of the financial information necessarily requires the use of some estimates and judgements, such as selection and application of accounting principles appropriate to the circumstances and with due consideration to materiality. Where appropriate, management seeks and receives guidance in these matters from external legal, accounting and other advisors.

To ensure the reliability of the financial statements, management relies on the Company's system of internal controls. The accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and it financial records are reliable.

KPMG, an independent firm of chartered accountants, reviewed the Company's internal controls and provided management and the audit committee with their recommendations for any improvements they deemed advisable. Management and the audit committee have reviewed these recommendations and are taking action to implement them. Management continuously monitors and adjusts the Company's internal controls and management information systems to accommodate a changing environment while ensuring financial integrity.

Management also recognizes its responsibility for ensuring that the Company, at all times, should conduct its affairs in an ethical manner, conforming to all applicable laws and regulations, and in accordance with the highest standards of personal and corporate conduct.

February 4, 2000	Brian Hamilton Chief Financial Officer	Stephen Verhoeff Chairman, President, CEO

Auditors' Report to Shareholders

We have audited the consolidated balance sheets of Communication Systems International Inc. as at December 31, 1999 and 1998 and the consolidated statements of operations and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1999 and 1998 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada
February 4, 2000

Consolidated Balance Sheets

Years ended December 31, 1999 and 1998

	1999	1998
Assets		
Current assets:		
Cash and term deposits	**$ 455,207**	$ 1,186,032
Accounts receivable	**2,221,937**	1,428,230
Income taxes recoverable	**38,967**	38,967
Inventories	**4,008,731**	726,057
Prepaid expenses and deposits	**317,736**	38,912
	7,042,578	3,418,198
Capital assets *(note 2)*	**1,524,045**	987,045
Deferred development costs *(note 3)*	**405,224**	223,207
Goodwill	**2,829,441**	6,659
	$ 11,801,288	$ 4,635,109
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness *(note 5)*	**$ 392,431**	$ -
Accounts payable and accrued liabilities	**3,720,903**	1,109,674
Current portion of senior long-term debt *(note 7)*	**292,329**	-
	4,405,663	1,109,674
Subordinated debt *(note 6)*	**2,335,856**	-
Senior long-term debt *(note 7)*	**1,023,210**	-
Shareholders' equity:		
Share capital *(note 8)*	**6,620,362**	6,708,429
Deficit	**(2,551,803)**	(3,119,994)
	4,068,559	3,588,435
Due from shareholders *(note 9)*	**(32,000)**	(63,000)
	4,036,559	3,525,435
Commitments *(note 13)*		
Subsequent event *(note 15)*		
	$ 11,801,288	$ 4,635,109

See accompanying notes to consolidated financial statements.

Approved by the Board:

Brian Hamilton
Director

Michael McCullagh
Director

Consolidated Statements of Operations and Deficit

Years ended December 31, 1999 and 1998

	1999	1998
Sales	**$ 16,359,809**	$ 8,349,778
Cost of sales	**9,440,730**	4,742,816
	6,919,079	3,606,962
Expenses:		
Selling	**2,481,788**	1,214,442
General and administrative	**1,646,185**	1,165,235
Interest on long-term debt	**251,279**	-
Depreciation and amortization	**710,783**	293,784
	5,090,035	2,673,461
Earnings before undernoted item	**1,829,044**	933,501
Research and development costs	**1,260,853**	509,827
Earnings before income taxes	**568,191**	423,674
Income taxes *(note 10)*	**-**	-
Net earnings	**568,191**	423,674
Deficit, beginning of year	**(3,119,994)**	(3,543,668)
Deficit, end of year	**$ (2,551,803)**	$ (3,119,994)
Earnings per common share:		
Basic	**$ 0.09**	$ 0.07
Fully diluted	**0.09**	0.07

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31, 1999 and 1998

	1999	1998
Cash flows from (used in) operating activities:		
Net earnings	$ **568,191**	$ 423,674
Items not involving cash:		
Depreciation and amortization	**710,783**	293,784
Foreign exchange	**(93,604)**	-
	1,185,370	717,458
Change in non-cash operating working capital:		
Accounts receivable	**1,287,938**	(915,509)
Income taxes recoverable	**-**	140,388
Inventories	**(1,045,988)**	606,625
Prepaid expenses and deposits	**(178,948)**	3,404
Accounts payable and accrued liabilities	**501,306**	77,026
	1,749,678	629,392
Cash flows from (used in) financing activities:		
Repurchase of common shares	**(73,077)**	(34,433)
Senior long-term debt	**1,349,439**	-
Subordinated debt	**175,560**	-
Issue of share capital, net of share issue costs	**16,010**	11,000
	1,467,932	(23,433)
Cash flows from (used in) investing activities:		
Purchase of capital assets	**(180,241)**	(221,345)
Deferred development costs, net of incentives and grants	**(310,998)**	(150,000)
Increase in note receivable	**-**	125,000
Acquisition *(note 4)*	**(3,849,627)**	-
	(4,340,866)	(246,345)
Increase (decrease) in cash position	**(1,123,256)**	359,614
Cash position, beginning of year	**1,186,032**	826,418
Cash position, end of year	**$ 62,776**	$ 1,186,032
Cash	**$ 455,207**	$ 1,186,032
Bank indebtedness	**392,431**	-
Cash position, end of year	**$ 62,776**	$ 1,186,032
Supplemental disclosure:		
Interest paid	**$ 139,993**	$ 24,161

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended December 31, 1999 and 1998

Communication Systems International Inc. (the "Company") was incorporated under the laws of the Province of Alberta. The Company designs and manufactures products that use differential global positioning technology in various applications.

1. Significant accounting policies:

(a) Principles of consolidation:

These consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned.

(b) Inventories:

Inventories are valued at the lower of cost and market with cost determined on an average cost basis and market determined at net realizable value for finished goods and work in progress, and replacement cost for component parts.

(c) Capital assets:

Capital assets are recorded at cost. Depreciation is provided at the following annual rates:

Computer equipment and software	declining balance	30%
Office and production equipment	declining balance	20% - 30%
Leasehold improvements	straight-line	5 years
Licenses and other assets	straight-line	3 to 10 years

Depreciation is charged at one half of the annual rate in the year of acquisition of an asset.

(d) Deferred development costs:

The Company is actively engaged in developing new technology and products in the differential global positioning system industry. Development costs related to a specific product or process that is proven to be technically and economically feasible are capitalized. Deferred development costs are amortized on a straight-line basis against future revenues over the period of expected benefit. If, at any time, the benefits of any costs capitalized are determined to no longer be of any value, such costs are written off in full. Any incentives or grants, received or receivable, which relate to the development activities of the Company are deducted from the capitalized amount in the period.

(e) Research costs:

Ongoing research costs, net of related incentives and grants, are charged to earnings in the current period.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. *Significant accounting policies (continued):*

(f) Goodwill:

Goodwill which represents the portion of the excess purchase price paid on the acquisition of businesses in excess of the value assigned to identifiable net assets acquired is amortized on a straight-line basis over a ten year period from the acquisition date. The value of goodwill is periodically evaluated and where there is considered to be an impairment in the estimated net recoverable amount of the goodwill, based upon expected cash flows, the goodwill is written down to its estimated value. Amortization for the year ended December 31, 1999 amounted to $232,415 (December 31, 1998 - $6,660).

(g) Measurement uncertainty:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(h) Earnings per share:

Basic earnings per share has been calculated using the weighted average number of common shares outstanding during the year. Fully diluted earnings per share reflects the exercise of stock options as if issued at the beginning of the year.

(i) Foreign currency translation:

Foreign currency balances of the Company's foreign subsidiary, which is considered to be integrated, are translated on the following basis:

- monetary assets and liabilities are translated at the rates of exchange prevailing at the balance sheet dates.
- non-monetary assets, liabilities and related depreciation expense are translated at historical rates.
- sales and expenses are translated at the average rate of exchange during the month in which they are recognized.

Any resulting foreign exchange gains and losses are included in earnings.

(j) Stock-based compensation plans:

The Company has a stock-based compensation plan, which is described in Note 8(d). No compensation expense is recognized for this plan when stock options are issued. Any consideration paid on exercise of stock options is credited to share capital.

Notes to Consolidated Financial Statements

1. *Significant accounting policies (continued):*

(k) Deferred income taxes:

The Company follows the deferral method of tax allocation accounting under which the provision for corporate income taxes is based on the earnings reported in the accounts and takes into account the tax effects of timing differences between financial statement and taxable income.

2. Capital assets:

December 31, 1999	Cost	Accumulated Depreciation	Net Book Value
Computer equipment and software	$ 726,903	$ 321,017	$ 405,886
Office and production equipment	1,158,757	444,293	714,464
Leasehold improvements	157,385	48,865	108,520
Licenses and other assets	420,600	125,425	295,175
	$ 2,463,645	$ 939,600	$ 1,524,045

December 31, 1998	Cost	Accumulated Depreciation	Net Book Value
Computer equipment and software	$ 453,628	$ 224,955	$ 228,673
Office and production equipment	635,221	259,506	375,715
Leasehold improvements	67,809	22,387	45,422
Licenses and other assets	420,600	83,365	337,235
	$ 1,577,258	$ 590,213	$ 987,045

3. Deferred development costs:

	1999	1998
Deferred development costs, net of incentives and grants	$ 1,162,806	$ 851,808
Accumulated amortization	(757,582)	(628,601)
	$ 405,224	$ 223,207

Notes to Consolidated Financial Statements

4. Acquisition:

Effective April 4, 1999, the Company acquired certain assets of Satloc Inc., a company in the business of supplying differential global positioning systems in the United States. Total consideration paid was $6,069,627, consisting of subordinated debt of $2,220,000, Senior term loan of $1,499,190 and cash of $2,350,437. Acquisition costs relating to the transaction amounted to $318,824. The acquisition was accounted for using the purchase method with the results of operations included from the date of acquisition. The cost of the net assets acquired at assigned values consisted of:

Working capital	$ 2,422,140
Capital assets	592,290
Goodwill	3,055,197
	$ 6,069,627

Pursuant to the asset purchase agreement, contingent consideration in the form of a maximum of 1,550,000 convertible preferred shares is payable to the vendor over a five year period ending January 1, 2004. The contingent consideration to be paid is dependent upon sales levels of the Satloc business and will be accounted for as additional goodwill. No additional consideration has been paid since the date of acquisition. The preferred shares accrue dividends at the rate of 10% per annum, however, no dividends will be paid until the preferred shares are converted or redeemed. The preferred shares are convertible into common shares at the greater of $1.00 per preferred share or the 30-day average trading price prior to April 1, 2004. The preferred shares are redeemable at the request of the vendor on or after April 1, 2004 and by the Company after April 1, 2007.

5. Bank indebtedness:

The Company has an operating line of credit to a maximum amount of $2,000,000 which bears interest at the bank prime rate plus 0.75% to 1.25%. This line of credit is secured by a general security agreement covering all assets of the Company. This facility was drawn $392,431 at December 31, 1999 (December 31, 1998 - $nil).

6. Subordinated debt:

The subordinated debt which arose on the acquisition of certain of the assets of Satloc Inc. (note 4) is comprised of a U.S. $1,500,000 unsecured promissory note bearing interest at 15% per annum and payable to the vendor on April 4, 2001. At December 31, 1999, unpaid interest of U.S. $118,750 is included within the subordinated debt.

Notes to Consolidated Financial Statements

7. Senior long-term debt

	1999	1998
U.S. $911,628 loan payable, requiring monthly payments of U.S. $16,882 plus interest at the bank's prime rate plus 1.75% per annum, due July 1, 2004, secured by a general security agreement covering all assets of the Company	$ 1,315,539	$ -
Less current portion	292,329	-
	$ 1,023,210	$ -

Principal payments due over the next five years are as follows:

2000	U.S.$ 202,584
2001	202,584
2002	202,584
2003	202,584
2004	101,292

8. Share Capital

(a) Authorized:

Unlimited number of common shares
Unlimited number of first preferred shares
Unlimited number of second preferred shares

(b) Common shares issued:

	Number of Shares	Amount
Balance, December 31, 1997	6,475,600	$ 6,767,862
Repurchase under normal course issuer bid	(50,000)	(34,433)
Share issue costs recovered	-	11,000
Forgiveness of shareholder loan *(note 9)*	-	(36,000)
Balance, December 31, 1998	6,425,600	6,708,429
Issued on exercise of stock options	21,875	16,010
Repurchase under normal course issuer bid	(85,100)	(73,077)
Forgiveness of shareholders loan *(note 9)*	-	(31,000)
Balance, December 31, 1999	6,362,375	$ 6,620,362

Notes to Consolidated Financial Statements

(c) Normal course issuer bid:

During 1998, the Company received approval to repurchase up to 300,000 common shares on the open market of the Toronto Stock Exchange. Total repurchases of 135,100 common shares were made between October 30, 1998 and the termination of the issuer bid on October 29, 1999.

(d) Stock options:

The Company has a stock option plan, whereby options to purchase common shares may be issued to directors, officers, employees, key consultants and agents of the Company subject to certain terms and conditions. Stock options granted vest over a period of two to four years and expire at various dates through 2004. At December 31, 1999, the exercise price of outstanding stock options was $0.73 to $1.05 per common share.

Changes in the number of options, with their weighted average exercise prices, are summarized below:

	1999		1998	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options outstanding, beginning of year	846,750	$ 1.49	846,500	$ 1.90
Granted	69,000	0.99	213,750	0.78
Exercised	(21,875)	0.73	-	-
Cancelled/Expired	(411,125)	2.26	(213,500)	2.41
Stock options outstanding, end of year	482,750	$ 0.80	846,750	$ 1.49
Exercisable at year end	382,865	$ 0.78	663,938	$ 1.65

(e) Share purchase warrants:

There was a common share purchase warrant outstanding entitling the holder to acquire 130,000 (December 31, 1998 - 130,000) common shares. The warrant, exercisable at $1.00 per common share, expired on October 27, 1999.

9. Due from shareholders:

The amounts due from shareholders are limited recourse loans which were advanced, prior to the Company's initial public offering, as an incentive for the exercise of options to purchase 216,500 common shares. These loans are repayable in annual installments which commenced on January 5, 1998 with final payments due on January 5, 2000. The Company agreed to pay each of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

these shareholders a bonus on the dates the loan amounts are due which will be used to satisfy the indebtedness. The Company's only recourse in respect of such loans is to realize upon the security interests granted by the borrowers; (i) on the common shares issued upon exercise of the options; and (ii) on the bonus payments to be made to the borrowers. The loans have been presented as a deduction from shareholders' equity. During 1999, $31,000 (1998 - $36,000) of the loans were forgiven.

10. Income taxes:

Income tax expense varies from the amount that would be computed by applying the combined Federal and Provincial income tax rate of 44.6% before income tax as follows:

	1999	1998
Basic rate of 44.6% applied to earnings before income tax	$ 253,413	$ 188,959
Increase (decrease) resulting from:		
Utilization of previously unrecognized losses	(192,273)	(126,687)
Other	10,314	9,182
Share issue costs	(71,454)	(71,454)
Income tax expense	$ -	$ -

As at December 31, 1999, the Company has reported non-capital losses for income tax purposes of approximately, $1,300,000 which may be used to reduce future years' taxable income. These losses begin expiring in 2004. In addition, the Company has assets for which income tax deductions available in future years exceed the recorded net book values by $1,400,000 (1998 - $2,140,000). These financial statements do not reflect the potential benefit of these items.

11. Segmented information:

(a) Operating segments:

The Company's method for determining what information to report about operating segments is based on the way that management organizes the operating segments within the Company for making operating decisions and assessing financial performance.

The Company's chief operating decision maker is considered to be the Company's President and CEO. The President and CEO reviews financial information presented on a divisional basis being the CSI division in Canada which manufactures and distributes DGPS devices and the Satloc division in the United States which is a supplier of precision guidance systems for purposes of making operating decisions and assessing financial performance.

Notes to Consolidated Financial Statements

	CSI		Satloc		Total	
	1999	1998	1999	1998	1999	1998
Sales	$ 9,804,384	$ 8,349,778	$ 6,555,425	$ -	$16,359,809	$ 8,349,778
Interest expense	75,591	-	175,688	-	251,279	-
Depreciation and amortization	374,601	293,784	336,182	-	710,783	293,784
Net earnings	557,022	423,674	11,169	-	568,191	423,674
Capital assets and goodwill	1,006,467	993,704	3,347,020	-	4,353,487	993,704
Total assets	6,454,220	4,635,109	5,347,068	-	11,801,288	4,635,109
Capital expenditures excluding acquisition	258,383	221,345	35,714	-	294,097	221,345

For the year ended December 31, 1998, the Company had only one operating segment being the CSI division in Canada.

(b) Sales by geographic segment:

	1999	1998
U.S.A.	$ 7,972,000	$ 3,542,000
Europe	3,820,000	3,420,000
Other	3,514,000	662,000
Canada	1,054,000	726,000

Sales are attributed to geographic segments based on the location of the customer.

(c) Major customers:

Of the Company's sales for the year ended December 31, 1999, 22% (1998 - 43%) were to three customers.

12. Financial instruments:

The carrying values of cash and term deposits, accounts receivable, income taxes recoverable, bank indebtedness, accounts payable and accrued liabilities, approximate their fair value due to the relatively short periods to maturity of these instruments. All long-term debt with variable interest rates is assumed to already be at fair value and therefore is not revalued. The fair value of the Company's vendor subordinated debt could not be determined because no market exists for this instrument.

Notes to Consolidated Financial Statements

13. Commitments:

The Company is committed to annual minimum lease payments, excluding tenant operating costs of:

2000	$ 462,000
2001	460,000
2002	315,000
2003	324,000
2004	4,000

14. Uncertainty due to the Year 2000:

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. Although the change in date has occurred, it is not possible to conclude that all aspects of the Year 2000 Issue that may affect the entity, including those related to customers, suppliers, or other third parties, have been fully resolved.

15. Subsequent event:

On January 31, 2000, the Company filed a Rights Offering pursuant to which each holder of a common share will receive one right for each common share held. Four rights will entitle the holder to subscribe for one common share at a price of $1.60 per common share. A maximum 1,591,031 common shares are issuable pursuant to this Rights Offering resulting in proceeds of approximately $2,345,000 net of $200,000 in estimated expenses.

Corporate Information

Communication Systems International Inc.

Directors

Stephen Verhoeff
President, Chairman and CEO

Brian Hamilton
Executive Vice President & CFO

Michael McCullagh
Vice-President, Manufacturing Operations

Michael Lang
Co-founder & Vice Chairman
Beau Canada Exploration

Howard Yenke
Businessman

Paul Camwell
Vice-President R&D,
Ryan Energy Technologies Inc.

Sharon August Jones
President & CEO
The Idea Mill, LLC

Officers

Jim Burge
Vice-President, Sales and Marketing

Theresa Lea
Vice-President, Finance & Admin.

Walter Feller
Vice-President, Engineering and R&D

Pierre Rouleau
General Manager, Satloc

Legal Counsel

Burnet, Duckworth and Palmer
Calgary, Alberta

Bankers

CIBC, Main Branch
Calgary, Alberta

Auditors

KPMG LLP,
Calgary, Alberta

Registrar and Transfer Agent

Montreal Trust,
Calgary, Alberta

Stock Listings

Toronto Stock Exchange
Ticker Symbol: CSY

Wholly-owned Subsidiaries

Satloc (1999) Inc.
#800, 15990 N. Greenway Hayden Loop
Scottsdale, Arizona
85260
Telephone: 480-348-9919
Fax: 480-348-6370

Leading Edge Technologies Ltd.
1200 - 58 Avenue SE
Calgary, AB
T2H 2C9
Telephone: 403-259-3311
Fax: 403-259-8866

Investor Relations

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Fax: 416-657-2300
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Annual Meeting

3.30 pm
Thursday, June 15th, 2000
The Belair Room, Westin Hotel,
4th Avenue & 3rd Street SW
Calgary, Alberta

Produced by Canada Corporate Communications

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