UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

MJK CLEARING, INC., Adv. Proc. No. 01-4257

Debtor.

James P. Stephenson, in his capacity as Trustee for the Estate of MJK Clearing, Inc., Adv. Proc. No. 04-4165

Plaintiff,

v.

Kyla Fant,

Defendant.

Plaintiff's Response to Defendant's Motion to Dismiss, Transfer or Abstain

Plaintiff James P. Stephenson (the "Trustee"), in his capacity as Trustee for the Estate of MJK Clearing, Inc. (the "MJK Estate"), responds to defendant Kyla Fant's motion to have the Court dismiss or transfer this adversary proceeding, or abstain from hearing this adversary proceeding as follows:

The Trustee asserts that Fant owes the Trustee over $700,000. By this action, the Trustee seeks the turnover and a judgment for all monies owed to the MJK Estate by Fant, and reimbursement of all costs and expenses incurred to enforce Fant's obligation to pay this debt, including but not limited to reasonable attorneys' fees, costs and disbursements.

As set forth in the Trustee's Complaint, Fant opened a margin loan account (Account No. 34087998) at R. J. Steichen & Co. ("Steichen"). Steichen's rights in and to the margin loan account were subsequently assigned to MJK Clearing, Inc. ("MJK"). Pursuant to the terms of the agreement under which the margin loan account was opened (the "Margin Agreement"), Fant borrowed money from Steichen and/or MJK, which borrowings and any deficiency in her account Fant agreed to pay on demand. On or about September 25, 2001, the date MJK suspended business activities, Fant owed MJK the sum of $597,194.97. Trustee Aff., ¶ 2.

By letter dated on or about January 18, 2002, the Trustee demanded payment of the outstanding principal and accrued interest of Fant's margin loan account. Fant failed to pay the outstanding balance of her margin loan account in full and failed to otherwise make arrangements for the transfer of the account. Trustee Aff., ¶ 2. The outstanding balance of Fant's account is $711,494.53 as of September 1, 2004, with interest continuing to accrue at a rate of 6% per year. No collateral securities are retained in the account. Trustee Aff., ¶ 3.

By her motion, Fant seeks to defer consideration of the merits of the Trustee's claims. She asks that this Court dismiss the Trustee's claims, transfer venue, or abstain from hearing the Trustee's claims. The Trustee submits that none of these requests is justified and that this Court is entitled to and should proceed to a determination on the merits of the Trustee's claims.

1. The Venue of this Adversary Proceeding is Proper.

Venue in this Court is proper because this Court has exclusive jurisdiction of this action under the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa, et seq. ("SIPA"). On September 27, 2001, the Securities Investor Protection Corporation filed a Complaint and Application (the "Application") against MJK in the United States District Court for the District of Minnesota (the "District Court"). The District Court entered an

Order (the "Order") commencing a SIPA liquidation proceeding against MJK (the "Liquidation Proceeding").

Pursuant to 15 U.S.C. § 78eee(b)(2)(A)(i), upon the filing of the Application, the District Court was granted **exclusive** jurisdiction over MJK and "its property wherever located (including property located outside the territorial limits of such court . . .)." Pursuant to 15 U.S.C. § 78eee(b)(2)(A)(iii), the District Court was also granted, except as inconsistent with the provisions of SIPA, the jurisdiction, powers, and duties conferred upon a court of the United States having jurisdiction over cases under 11 U.S.C. §§ 101, et seq. (the "Bankruptcy Code").

Pursuant to the Order and 15 U.S.C. § 78eee(b)(2)(B)(4), the entire Liquidation Proceeding was removed to this Court and assigned Adversary Number 01-4257. The Liquidation Proceeding is now pending in this Court. Pursuant to 15 U.S.C. § 78eee(b)(2)(B)(4), this Court possesses all of the jurisdiction, powers, and duties conferred upon the District Court under 15 U.S.C. § 78eee(b)(2)(A).

SIPA incorporates the provisions of chapters 1, 3 and 5, and subchapters I and II of chapter 7 of the Bankruptcy Code. 15 U.S.C. § 78fff(b). Here, the Trustee, as required by SIPA, has asserted claims respecting the property of the MJK Estate (over which this Court has exclusive jurisdiction) consistent with the provisions of SIPA and the Bankruptcy Code. The Trustee asserts that Fant owes a debt to the MJK Estate that is matured and payable on demand. The debt is property of the MJK Estate. See 11 U.S.C. § 541(a)(1); In re Crysen/Montenay Energy Co., 902 F.2d 1098, 1101 (2d Cir. 1990) (property of the estate includes debtor's rights of action to collect accounts). And pursuant to 11 U.S.C. § 542(b), the Trustee may seek the turnover of that debt to the Trustee. See Nuckols and Assocs. v.

Bouchard Transp. Co., 109 B.R. 294, 295 (Bankr. S.D. Ohio 1989); Acolyte Elec. Corp. v. City of New York, 69 B.R. 155, 172 (Bankr. E.D. N.Y. 1986) (collection of mature debt is proper subject of turnover proceeding).

In short, under SIPA, this Court has exclusive jurisdiction over the Trustee's claims and the property of the MJK Estate. The pursuit of the Trustee's claims in a manner consistent with the Bankruptcy Code (as mandated by SIPA) does not nullify or otherwise affect this Court's exclusive jurisdiction under SIPA.

As jurisdiction in this Court is exclusive, this Court is the appropriate court in which to file this action. Venue is by definition proper. See National Labor Relations Board v. Line, 50 F.3d 311, 314 (5th Cir. 1995) ("[v]enue is necessarily defined as the appropriate district court to file an action"); 17 Moore's Federal Practice, § 110.01(1) (3d ed. 2004).

Even if the grant of exclusive jurisdiction to this Court pursuant to 15 U.S.C. § 78eee(b)(2)(A)(i) were not determinative, venue in this Court would still be proper under the general jurisdiction provisions of a court under the Bankruptcy Code. Pursuant to 15 U.S.C. §§ 78eee(b)(2)(A)(iii) and 78eee(b)(4), this Court also has the jurisdiction conferred upon a court of the United States having jurisdiction over cases under the Bankruptcy Code. The parties do not dispute that, if the Liquidation Proceeding was a case under the Bankruptcy Code rather than a SIPA liquidation proceeding, this Court would have original, if not exclusive, jurisdiction over this matter. See 28 U.S.C. §§ 1334(b) and 157(a). However, Fant incorrectly asserts that venue would not be appropriate in this Court if the Liquidation Proceeding were a case under the Bankruptcy Code.

28 U.S.C. § 1409(a) provides that except as otherwise provided in subsections (b) and (d), a proceeding arising under title 11 or "arising in or related to a case" under title 11 may

be commenced in the district court in which such case is pending. Subsection (b) requires small claims to be commenced in the district court for the district in which the defendant resides. The Trustee's claim against Fant is in excess of $700,000. Subsection (b) is not applicable.

Subsection (d) imposes certain requirements on cases related to claims "arising after the commencement" of a title 11 case from the operation of the business of the debtor. The claims asserted in this matter did not arise after the commencement of the Liquidation Proceeding. Rather, Fant borrowed the money she now owes before the commencement of the Liquidation Proceeding. The Trustee is simply trying to collect what was owed MJK at the time the Liquidation Proceeding was commenced. Subsection (d) is not applicable.

Finally, even if all of the Trustee's claims were post-petition, venue in this Court would still be appropriate as this is the judicial district in which a substantial part of the events giving rise to the claim occurred. 28 U.S.C. § 1391(a)(2). Fant is alleged to have opened an account and entered into an agreement with Steichen (a resident of this judicial district), is alleged to have borrowed money from Steichen and MJK (residents of this judicial district), and had to make her payments to Steichen and MJK (residents of this judicial district). See Burger King Corp. v. Thomas, 755 F.Supp. 1026, 1029 (S.D. Fla. 1991) (claim arose in district to where payments were to be sent).

2. This Adversary Proceeding is not Barred by the Statute of Limitations.

Fant asserts that the Trustee's claim is barred by the Alabama statute of limitations respecting actions based on an open account. Fant is wrong. First, even if one assumes that Alabama law applies (an assumption the Trustee contests), the correct limitations period is six years, not three years.

The Trustee asserts three claims – a turnover claim under 11 U.S.C. § 542(b), a breach of contract claim, and an account stated claim. Fant points to Ala. Code § 6-2-37 and argues that its three year limitations period on open accounts bars the Trustee's claims. None of the Trustee's claims, however, is a claim on an open account. Under Alabama law, an open account is one where a provision of the contract is left open for further negotiations. Wal-Mart Stores, Inc. v. Anniston Development Company, 853 So.2d 218, 221 (Ala. 2002). Fant did not have such a contract with Steichen or MJK. No further negotiations were contemplated and none are alleged.

Instead, if Alabama law applies, the Trustee's claims are subject to a six year limitations period. The Trustee's breach of contract claim would be governed by Ala. Code § 6-2-34(4) providing for a six year limitations period for breach of contract actions. See The Home Indemnity Company v. Ball-Co Contractors, Inc., 819 F.2d 1053, 1054 (11th Cir. 1987) ("Alabama has a six-year statute of limitations for breach of contract actions."). The Trustee's account stated claim would be governed by is Ala. Code § 6-2-34(5) providing for a six year limitations period for an account stated. See Defco, Inc. v. Decatur Cylinder, Inc., 595 So.2d 1329, 1332 (Ala. 1992) ("The statutory period of limitations for an account stated is six years, Ala. Code § 6-2-34(5), and, for an open account, three years, § 6-2-37(1)."). Therefore, the Trustee's claims are timely even if one assumes that Alabama law applies.

As to whether Minnesota or Alabama law applies, the Trustee believes that his claims against Fant are governed by Minnesota law pursuant to the terms of the parties' agreement as described in the Trustee's Complaint. And even if this Court had to resort to a traditional choice of law analysis, it would first need to determine whether an actual conflict exists between the laws of the two states, that is, whether the choice of one law will be "outcome determinative." Hague v. Allstate Insurance Co., 289 N.W.2d 43, 46-47 (Minn.), aff'd, 449 U.S. 302 (1981); Gate City Federal Savings & Loan Association v. O'Connor, 410 N.W.2d 448, 450 (Minn. Ct. App. 1987). Here, the choice of law is not outcome determinative as Minnesota also has a six year limitations period for breach of contract and account stated claims. Minn. Stat. § 541.05, subd. 1(1).[1]

3. This Adversary Proceeding Should Not be Transferred.

Fant asserts that this action should be transferred to Alabama. Transfer is not appropriate. First, under 15 U.S.C. § 78eee(b)(2)(A)(i), this Court has exclusive jurisdiction over this action. No other Court may properly entertain this lawsuit. Indeed, if Fant had sued the Trustee in Alabama, then under 28 U.S.C. § 1631 the Trustee would have been entitled to have the action transferred to this Court as it is the court with exclusive jurisdiction. See In re Apex Oil Co., 884 F.2d 343, 346 (8th Cir. 1989) (transfer of bankruptcy appeal to court with subject matter jurisdiction to hear appeal); 17 Moore's Federal Practice, § 111.51(2) (3d ed. 2004) ("the courts have routinely transferred actions under Section 1631 to the particular court having exclusive subject matter jurisdiction").

Second, even if a federal court in Alabama would have jurisdiction over this matter, Fant has failed to meet her burden of proving that transfer is appropriate. Fant asserts only that she is over one thousand miles from the location of this Court. Fant's "proof" amounts only to a request to transfer the inconvenience to the Trustee. This proof is insufficient. See

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[1] Even if choice of law was outcome determinative, the Trustee asserts that Minnesota law applies. According to Minnesota choice-of-law principles, a Minnesota court determines whether Minnesota law or the law of another jurisdiction applies by analyzing several "choice-influencing" factors: (a) predictability of result; (b) maintenance of interstate and international order; (c) simplification of the judicial task; (d) advancement of the forum's governmental interests; and (e) application of the better rule of law. Milkovich v. Saari, 295 Minn. 155, 203 N.W.2d 408, 412 (1973). Here, the Trustee believes these factors weigh in favor of the application of Minnesota law.

In re Astrocade, Inc., 79 B.R. 983, 985 (Bankr. S.D. Ohio 1987) (venue not transferred where change would merely shift inconvenience); In re Windsor Communications Group, Inc., 53 B.R. 293, 296 (Bankr. E.D. Pa. 1985) (burden of proof under section 1412 is on party requesting transfer and unless balance is strongly in favor of defendant, plaintiff's choice of forum should rarely be disturbed).

Third, in any event, venue should be in this Court. Fant is alleged to owe over $700,000. The Trustee's claim is not insubstantial. Witnesses reside in Minnesota. The Trustee is here. Fant's account representative, Timothy Floeder, is a Minnesota resident. Trustee Aff., ¶ 6. Fant's account statements and correspondence reflect her significant investment in HEI, Inc., a Minnesota company of which her brother, Anthony Fant, was president. Trustee Aff., Exs. A, B and C. On the whole, the economic and efficient administration of the MJK Estate suggests that Minnesota venue is proper.

4. The Court Should Not Abstain from Hearing this Adversary Proceeding.

Fant asks that this Court abstain from hearing this action under 28 U.S.C. § 1334(c)(1). Abstention is not appropriate. Again, under 15 U.S.C. § 78eee(b)(2)(A)(i), this Court has exclusive jurisdiction over this matter. There is no other court that can properly hear this action. In other words, there is no court to which this Court can abstain.

Even if this Court were to apply the rules applicable to a court hearing a case under the Bankruptcy Code, abstention would still not be appropriate. The Trustee asserts a turnover claim, so this proceeding is a core proceeding under 28 U.S.C. § 157. In addition, any state law issues required for a resolution of the Trustee's claims are common and settled. There is simply no unique unsettled state law issue of substantial public import that would necessitate abstention. Accordingly, abstention is inappropriate. See Matter of Baldwin-

United Corp., 48 B.R. 49, 54 (Bankr. S.D. Ohio 1985) (turnover proceedings initiated by debtor pursuant to 11 U.S.C. § 542(b) to collect on allegedly overdue loans are properly before Bankruptcy Court since such proceedings constitute core proceedings under 28 U.S.C. § 157(b) and no unsettled question of state law is present warranting abstention under section 1334 (c)(1)); In re Double TRL, Inc., 65 B.R. 993, 1002 (Bankr. E.D. N.Y. 1986).

Abstention under 28 U.S.C. § 1334(c)(1) is appropriate only if resolution of state law issues involves matters of substantial public import and if there is no state precedent to guide the court. See Ronix Corp. v. Philadelphia, 82 B.R. 19, 20 (E.D. Pa. 1988); In re Allegheny, Inc., 68 B.R. 183, 192 (Bankr. W.D. Pa. 1986) (bankruptcy court declined to abstain because action involves no unique issues of state law and bankruptcy court is not less suited than appropriate state court to determine outcome of case); In re Altchek, 119 B.R. 31, 34 (Bankr. S.D. N.Y. 1990) (discretionary abstention under 28 U.S.C. § 1334(c)(1) is inappropriate regarding debtor's state law causes of action for collection of accounts receivable because (1) there is no action pending in state courts covering same subject matter and so no conflict with interest of comity with state courts, and (2) because there is no question as to unsettled issues of state law or matters of substantial public importance, and thus respect for state law does not warrant abstention). Here, the circumstances do not justify abstention.

Conclusion

For all the reasons stated above, the Trustee respectfully requests that this Court deny Fant's motion to dismiss, transfer or abstain.

Dated: October 28, 2004

FAEGRE & BENSON LLP

D. Charles Macdonald #151385
Gretchen J. August #274604
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, Minnesota 55402-3901
(612) 766-7000

Attorneys for James P. Stephenson, in his capacity as Trustee for the Estate of MJK Clearing, Inc.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

MJK CLEARING, INC., Adv. Proc. No. 01-4257

Debtor.

James P. Stephenson, in his capacity as
Trustee for the Estate of MJK Clearing, Inc., Adv. Proc. No. 04-4165

Plaintiff,

v.

Kyla Fant,

Defendant.

AFFIDAVIT OF TRUSTEE

STATE OF MINNESOTA)
) SS.
COUNTY OF HENNEPIN)

James P. Stephenson, first being duly sworn, states under oath:

1. I am a partner with the law firm of Faegre & Benson, LLP in Minneapolis, Minnesota and am the Trustee for the Estate of MJK Clearing, Inc. As Trustee, I am currently in the process of liquidating the Estate of MJK Clearing. As part of the liquidation, I am seeking to close out all accounts held by MJK Clearing, Inc. ("MJK") and recover any monies due and owing to MJK.

2. To the best of my knowledge, information and belief, the facts alleged in the Complaint in this case are true and correct as follows:

a. Defendant Kyla Fant ("Fant") opened an account (Account No. 34087998) at R. J. Steichen & Co. ("Steichen"). Steichen's rights in and to the account were subsequently assigned to MJK for value.

b. Upon information and belief, pursuant to the terms of the agreement under which the account was opened (the "Agreement"), Fant borrowed money from Steichen and/or MJK or otherwise created a deficiency in the account, which borrowings and any deficiency in her account Fant agreed to pay on demand. On or about September 25, 2001, the date MJK suspended business activities, Fant owed MJK the sum of $597,194.97. Interest accrued on the outstanding balance thereafter at the rate of 6% per year.

c. By letter dated on or about January 18, 2002, the Trustee demanded payment of the outstanding principal and accrued interest of Fant's account. Fant failed to pay the outstanding balance of her account and failed to otherwise make arrangements for the transfer of the account.

3. The outstanding balance of Fant's account is $711,494.53 as of September 1, 2004, with interest continuing to accrue at a rate of 6% per year. No collateral securities are retained in the account.

4. Attached as Exhibit A are true and correct copies of account statements for Fant's account in my possession.

5. Attached as Exhibit B are true and correct copies of correspondence between Kyla Fant and Tim Floeder, Fant's account executive, in my possession.

6. Upon information and belief, Tim Floeder is a Minnesota resident.

7. Attached as Exhibit C is a true and correct copy of an excerpt of the 2003 Annual Report of HEI, Inc., including Part I of HEI, Inc.'s 10-K.

FURTHER AFFIANT SAYETH NAUGHT.

James P. Stephenson

Subscribed and sworn to before me
this 24th day of October, 2004.

Notary Public
M2:20663229.01

PENNY L. PASZKIEWICZ
Notary Public
Minnesota
My Commission Expires Jan. 31, 2005

MILLER, JOHNSON & KUEHN, INC.
INVESTMENT SECURITIES

5500 WAYZATA BLVD., SUITE 800
MINNEAPOLIS, MINNESOTA 55416
(612) 542-6000 (800) 537-7829

BRANCH OFFICES:
SCOTTSDALE, ARIZONA
SAN DIEGO, CALIFORNIA

ACCOUNT NUMBER	TAX ID NUMBER	PRIOR PERIOD	PERIOD ENDING	OFFICE	AE NUMBER	PAGE
34087998	421-29-0416	09/28/01	12/31/01	89S	8999	1

KYLA FANT
2154 HIGHLAND AVENUE SOUTH
BIRMINGHAM AL 35205

YOUR ACCOUNT EXECUTIVE
SIPC

SIPC

ACCOUNT SUMMARY

ACCOUNT VALUE	MARKET VALUE	ALLOCATION
PRICED SECURITIES PRIOR PERIOD	<597,194.97>	
	==============	
MARGIN CASH BALANCES	<598,289.83>	100.00%
PRICED SECURITIES THIS PERIOD *	<598,289.83>	100.00%

EARNINGS SUMMARY	CURRENT	YEAR TO DATE
INCOME		
TOTAL INCOME	0.00	0.00
EXPENSE		
MARGIN INTEREST	<1,094.86>	<8,003.86>
TOTAL EXPENSES	<1,094.86>	<8,003.86>

TRANSACTION SUMMARY	
OPENING BALANCE	<597,194.97>
EXPENSES	<1,094.86>
CLOSING BALANCE	<598,289.83>

ACCOUNT ACTIVITY

MARGIN ACCOUNT

DATE	TRANSACTION	QUANTITY	DESCRIPTION	PRICE	AMOUNT	BALANCE
			OPENING BALANCE			<597,194.97>
12/31/01	INTEREST		DEBIT INTEREST 11 DAYS AVG BL 597194.97 AVG RATE 6.000		<1,094.86>	<598,289.83>
			CLOSING BALANCE			<598,289.83>

* END OF STATEMENT *

Exhibit A

MILLER, JOHNSON & KUEHN, INC.
INVESTMENT SECURITIES
5500 WAYZATA BLVD., SUITE 800
MINNEAPOLIS, MINNESOTA 55416
(612) 542-6000 (800) 537-7829

BRANCH OFFICES:
SCOTTSDALE, ARIZONA
SAN DIEGO, CALIFORNIA

ACCOUNT NUMBER	TAX ID NUMBER	PRIOR PERIOD	PERIOD ENDING	OFFICE	AE NUMBER	PAGE
34087998	421-29-0416	08/31/01	09/28/01	99E	RP02	1

KYLA FANT
2154 HIGHLAND AVENUE SOUTH
BIRMINGHAM AL 35205

YOUR ACCOUNT EXECUTIVE
TIMOTHY F FLOEDER

5500 WAYZATA BLVD #800
MINNEAPOLIS MINNESOTA 55416
.
1-800-537-7829/763 542-6000

ACCOUNT SUMMARY

ACCOUNT VALUE	MARKET VALUE	ALLOCATION
PRICED SECURITIES PRIOR PERIOD	<593,821.54>	
	==============	
MARGIN CASH BALANCES	<597,194.97>	100.00%
PRICED SECURITIES THIS PERIOD *	<597,194.97>	100.00%

EARNINGS SUMMARY	CURRENT	YEAR TO DATE
INCOME		
TOTAL INCOME	0.00	0.00
EXPENSE		
MARGIN INTEREST	<3,373.43>	<6,909.00>
TOTAL EXPENSES	<3,373.43>	<6,909.00>

TRANSACTION SUMMARY	
OPENING BALANCE	<593,821.54>
EXPENSES	<3,373.43>
CLOSING BALANCE	<597,194.97>

ACCOUNT ACTIVITY

MARGIN ACCOUNT

DATE	TRANSACTION	QUANTITY	DESCRIPTION	PRICE	AMOUNT	BALANCE
			OPENING BALANCE			<593,821.54>
09/28/01	INTEREST		DEBIT INTEREST 28 DAYS AVG BL 593821.54 AVG RATE 7.303		<3,373.43>	<597,194.97>
			CLOSING BALANCE			<597,194.97>

* END OF STATEMENT *

Fant Industries
2154 Highland Ave South
Birmingham, AL 35205
(205) 933-1030 Fax (205) 933-9456

Fax

To:	Tim Floeder	**From:**	Kyla Fant
Fax:	(952) 341-6223	**Pages:**	11
Phone:		**Date:**	2/16/01
Re:		**CC:**	

☐ **Urgent** ☐ **For Review** ☐ **Please Comment** ☐ **Please Reply** ☐ **Please Recycle**

Tim,

Please call Jeff Converse or me at 933-0507 if you have any problems with the receiving firms.

Thanks,

Kyla

Exhibit B

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

American Express Brokerage
70400 AXP Financial Center
Minneapolis, MN 55474
DTC # 0216

For further credit to:

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 3551-2078-3-021

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

Datek Online
DTC # 0544

For further credit to:

Kyla B. Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 668-4993

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

ETrade
DTC # 0385

For further credit to:

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 4868-5399

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

Muriel Siebert
DTC # 0226

For further credit to:

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # TF0-035572

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

Charles Schwab
DTC # 0164

For further credit to:

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 3205-9900

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

Quick and Reilly
DTC # 0158

DK "your delivery"

For further credit to:

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 186-01104-26

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

Regions Investment Company
DTC # 0776

For further credit to:

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 0122671118

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

Fidelity
DTC # 0226

For further credit to:

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # X02332593

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

Southtrust Securities
DTC # 0632

For further credit to:

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 14416373

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

Compass Brokerage
DTC # 0443

For further credit to:

DK "no instructions to receive"

Kyla Beth Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 5K4-418662

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

Letter of Authorization

Via Telefax (612) 341-6262

February 14, 2001

Mr. Tim Floeder
Miller, Johnson, Steichen & Kinnard
One Financial Plaza
Suite 100
120 South 6th Street
Minneapolis, Minnesota 55402-1800

Re: Account # 161-762

Dear Tim:

Please transfer 12,500 shares of HEI, Inc., (Nasdaq: HEII), with pro-rata margin debt, to the following account which is in my name individually:

CFSB Direct
DTC # 0443

For further credit to:

Kyla B. Fant
1716 Riverchase Trail
Birmingham, AL 35244

Account # 011994779

DK "no instructions to receive"

Thank you for your assistance in the matter. I can be reached at 205-933-1030 if you have any questions regarding these instructions.

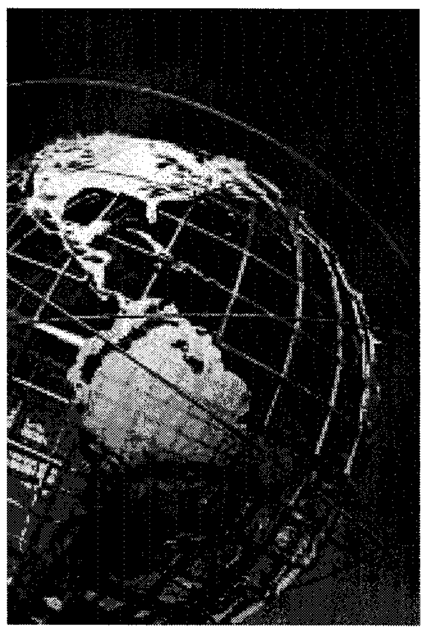
Very truly yours,

Kyla Beth Fant

Kyla Beth Fant

TURNING

TECHNOLOGY



TO YOUR

ADVANTAGE

HEI INC

2003 Annual Report

Exhibit C

To Our Shareholders,

First of all, we would like to thank each of you, our shareholders, for your patience and support during the past year. HEI is a very different and better company today than compared to one year ago. We recognized that significant changes were necessary to return the company to profitability and have taken many of the steps necessary to achieve that goal.

The acquisition of our Advanced Medical Operations has effectively doubled the size of HEI and, more importantly, given us broader strategic capabilities with which to serve our key strategic customers. The Class III medical manufacturing facilities in Boulder, combined with new product design services, positions HEI to be a very important strategic vendor to original equipment manufacturers (OEMs) in the medical device industry.

Our results in the hearing market, where we now have programs in place with 5 of the top 10 OEMs in the world, speaks volumes about the skills of both our sales and operational personnel. We continue to gain market share in the hearing market and expect this to be one of our pillars of success in the future.

During 2003, HEI continued to invest in technology platforms to increase the value of our offerings to our customers. The technology platforms provide us a means to design and build new products faster, cheaper and better than our customers could do by themselves. Building our proprietary technology into our customers' products increases the value proposition to our customers and translates into higher gross margins on our manufacturing services.

As we enter 2004, HEI has a bigger backlog of business than at any time in its history. Our sales force is committed to increasing revenues by applying HEI's core competencies in each of our markets. We are focused upon winning more programs from existing customers and seeking new customers whose needs intersect with our core competencies.

The management team continues to focus on its commitment to become a profitable company by increasing sales volume and critical management of operating expenses. We hope you share in our enthusiasm for the success of HEI.

Again, we thank you for your support and invite each of you to contact us with your thoughts, concerns or opportunities.

Sincerely,

Mack V. Traynor, III
President & CEO
HEI, Inc.
mack_t@heii.com

Dennis J. Leisz
Chairman of the Board
HEI, Inc.
dleisz@wavecrest.com

Highlights

January 7, 2003 - HEI announces new board members and management changes. Dennis Leisz and Timothy Floeder appointed to HEI Board replacing Edwin Finch and David Ortlieb.

January 28, 2003 - HEI acquires the Colorado Operations of Colorado MEDtech, Inc., a leading medical equipment design and manufacturing division.

March 19, 2003 - HEI Board appoints Mack Traynor as CEO and President and Dennis Leisz as Chairman of the Board, (replacing Anthony J. Fant).

May 5, 2003 - HEI S-3 Statement declared effective by SEC, thereby fulfilling HEI's obligation under the assent purchase agreement to register the one million shares of HEI stock issued to Colorado MEDtech, Inc. in January 2003.

HEI, supplies hearing circuits to the world's leading hearing instrument manufacturers.

May 28, 2003 - Samsys Technologies signs VAR agreement with HEI to provide specialty RFID solutions in manufacturing packaging.

May 29, 2003 - HEI enters into into a relationship with Beacon Bank of Shorewood, MN establishing a Credit Agreement and replacing LaSalle Business Credit LLC of Chicago, IL.

June 3, 2003 - HEI exhibits combined microelectronic and advanced medical device capabilities at the Medical Design and Manufacturing Conference and Exposition in New York City, including Link-iT (TM) connectivity technology for two-way patient-device-network communication.

June 5, 2003 - HEI signs Solutions Partnership agreement with Cerner Corporation to pursue development of medical and healthcare information connectivity solutions.

June 20, 2003 - HEI announces the selection of Douglas Nesbit to become CFO effective June 30.

June 30, 2003 - HEI appoints to its board of directors Michael Evers, Ph.D., dean emeritus and professor of strategic management at the University of St. Thomas, and George Heenan, director of the Institute for Strategic Management (ISM) at the the University of St. Thomas.

July 2, 2003 - HEI announces assignment of new corporate executives and the promotion of Dr. Scott Stole to the position of Chief Technical Officer.

July 23, 2003 - HEI demonstrates its combined microelectronic packaging, microfluidic, high density interconnect, and advanced medical device development and manufacturing capabilities at the Clinical Lab Expo 2003, in Philadelphia, Pennsylvania.

August 26, 2003 - HEI achieves ISO9001-2000 certification upon its successful completion of its external assessment by the NSAI.

Company Profile

HEI designs, develops, and manufactures microelectronic packaging, high-density interconnect, subsystem, system, connectivity, and medical/HIT software solutions. HEI's unique range of capabilities in product realization give a competitive advantage to OEMs engaged in medical software, hearing, medical devices, therapeutics, diagnostics, biotechnology, healthcare information, RFID, medical imaging, and communications.

Microelectronics Operations
Minneapolis, MN

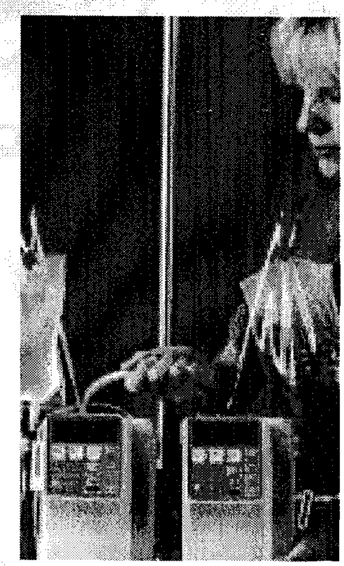
HEI's Microelectronics Operations specialize in advanced microelectronics packaging solutions based on high performance flex, rigid-flex and thin-rigid laminates fabricated in its dedicated Tempe, AZ facility.
HEI provides design and manufacturing of multichip modules, chip on laminate, chip on flex, flip chip / wirebond / chip scale packaging / ball grid arrays, and chip stacking.
Value-added engineering services include simulation, design, prototype, design for manufacturing, automated test engineering, qualification & reliability testing

Advanced Medical Operations
Boulder, CO

HEI's Advanced Medical Operations are a leader in the design, development, and manufacture of therapeutic devices, diagnostic instruments, and imaging systems and provide medical software development for laboratory, point-of-care, and hospital information systems. HEI is an expert in medical connectivity applications including clinical data conversion, remote diagnostics, and clinical error checking.
Value-added engineering services include product definition, design, clinical prototypes, design for manufacturing, automated test engineering, and independent quality testing.

The Boulder facility is an FDA registered Class III medical device manufacturer specializing in lean-flow manufacturing and supply chain management.

Markets served include medical implantables, therapeutic, diagnostic and imaging equipment, and hearing instrument OEMs.



HEI designs, develops, and manufact
that are smaller, more efficient, and

Financial Highlights

The selected, consolidated financial information presented below for each of the five years ended August 31 is derived from our consolidated financial statements. This information should be read in conjunction with the sections entitled "Consolidated Financial Statements" and the Notes thereto, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our Annual Report on Form 10-K. Certain reclassifications have been made to prior year financial statements to conform to the current presentation. The acquisition of Cross Technology, Inc. ("Cross") on March 3, 2000 was accounted for as a pooling of interests. Accordingly, we have restated all periods presented to account for the acquisition as if Cross had always been consolidated. All numbers are in thousands, except per share amount.

	Years Ended August 31(a)				
STATEMENT OF OPERATIONS DATA:	**2003(b)**	**2002**	**2001(c)**	**2000**	**1999**
Net sales and service	$38,440	$28,532	$44,832	$42,799	$29,089
Gross profit	$7,113	$5,157	$7,991	$7,255	$6,711
Net (loss) income	$(4,629)	$(3,892)	$(3,193)	$(1,155)	$393
(Loss) earnings per share					
Basic	$(0.70)	$(0.65)	$(0.65)	$(0.24)	$0.08
Diluted	$(0.70)	$(0.65)	$(0.65)	$(0.24)	$0.08
STATEMENT OF CASH FLOWS DATA:					
Net cash provided by (used in)					
Operating activities	$322	$1,077	$3,930	$(5,521)	$3,353
Investing activities	$(634)	$(2,423)	$(3,889)	$(585)	$(1,034)
Financing activities	$(1,254)	$(675)	$3,868	$4,547	$(759)
BALANCE SHEET DATA:					
Cash and cash equivalents	$806	$3,372	$4,393	$570	$2,338
Short-term investments	$-	$-	$-	$-	$3,744
Current assets	$14,387	$11,315	$13,929	$15,828	$12,727
Total assets	$26,503	$22,989	$27,528	$28,936	$23,739
Current liabilities	$8,636	$6,946	$5,136	$9,926	$4,394
Total long-term debt	$2,555	$1,473	$3,972	$3,894	$3,415
Total shareholders' equity	$13,191	$14,570	$18,420	$15,116	$15,566
Cash dividends per share	$-	$-	$-	$-	$-

:ures medical devices
easier to use.

(a) In March 2000, HEI acquired Cross Technology, Inc. in a pooling of interests transaction. Due to the nature of a pooling of interests transaction, the selected financial data are restated to reflect combined activities of HEI and Cross Technology prior to the acquisition.

(b) In January 2003, HEI acquired certain assets and liabilities of Colorado MEDtech, Inc.'s Colorado Operations.

(c) In the third quarter of fiscal year 2001, we closed the Mexico division.

HEI's Link-iT(TM) Technology links patients, devices, healthcare professionals and hospital networks. The technology benefits hospitals, device manufacturers and hospital information system vendors.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

☑ **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For fiscal year ended August 31, 2003.

or

☐ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission file number 0-10078

HEI, Inc.
(Exact name of registrant as specified in its Charter)

Minnesota *(State or other jurisdiction of incorporation or organization)*	**41-0944876** *(I.R.S. Employer Identification No.)*
P.O. Box 5000, 1495 Steiger Lake Lane **Victoria, MN** *(Address of principal executive offices)*	**55386** *(Zip Code)*

Issuer's telephone number, including area code:
(952) 443-2500

Securities registered pursuant to Section 12(b) of the Exchange Act:
None

Securities registered pursuant to Section 12(g) of the Exchange Act:
Common Stock, Par Value $.05 Per Share
(Title of Class)

Indicate by check mark whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☐ No ☑

The aggregate market value, in thousands, of the voting and non-voting common equity held by nonaffiliates as of the last business day of the registrant's most recently completed second fiscal quarter (based on the closing price as reported by The NASDAQ National Market): $12,907,000.

As of December 15, 2003, 7,045,791 Common Shares, par value $.05 per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement for the Registrant's 2004 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission are incorporated by reference into Part III of this Annual Report on Form 10-K.

FORWARD-LOOKING STATEMENTS

Some of the information included in this Annual Report on Form 10-K contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as "may," "will," "expect," "anticipate," "believe," "intend," "estimate," "continue," and similar words. You should read statements that contain these words carefully for the following reasons: such statements discuss our future expectations, such statements contain projections of future earnings or financial condition and such statements state other forward-looking information. Although it is important to communicate our expectations, there may be events in the future that we are not accurately able to predict or over which we have no control. The risk factors included in Item 7 of this Annual Report on Form 10-K provide examples of such risks, uncertainties and events that may cause actual results to differ materially from our expectations and the forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, as we undertake no obligation to update these forward-looking statements to reflect ensuing events or circumstances, or subsequent actual results.

HEI, Inc. and subsidiaries are referred to herein as "HEI," the "Company," "us," "we" or "our," unless the context indicates otherwise. All dollar amounts are in thousands of US dollars except for per share amounts.

PART I

Item 1. *Business.*

Business Development

We are a Minnesota corporation and were incorporated as Hybrid Electronics Inc. in 1968 and changed our name to HEI, Inc. in 1969. During our fiscal year ended August 31, 2000 ("Fiscal 2000"), we acquired Cross Technology, Inc. ("Cross"), now our wholly owned subsidiary. The acquisition of Cross was a strategic move to expand our product offerings in the ultraminiature markets that we serve. We opened our Mexico operation in Fiscal 2000 focusing on low cost contract assembly and closed this facility during our fiscal year ended August 31, 2001 ("Fiscal 2001"), primarily as a result of lack of profitability, disposing of some assets and relocating some assets to our other facilities.

On January 24, 2003, we acquired certain assets and assumed certain liabilities of Colorado MEDtech, Inc.'s ("CMED") Colorado operations ("Advance Medical Operations" or "AMO") in a business combination accounted for as a purchase. In connection with this acquisition, we issued one million shares of our common stock and assumed approximately $900 of AMO liabilities, as well as an operating lease and other contractual commitments. The purchase price of AMO was $2,600 based upon the closing market price of a share of our common stock the day the acquisition was finalized and consummated, as quoted on the NASDAQ National Market. The excess of the fair value of net assets over the purchase price in the amount of $3,760 has been allocated to reduce the carrying value of identifiable long-lived tangible and intangible assets.

Business of the Company

Principal Products and Services

Overview

HEI provides a comprehensive range of engineering, product design, automation and test, manufacturing and fulfillment services and solutions to our customers in the hearing, medical device, medical equipment, communications, computing and industrial equipment industries. We provide these services and solutions on a global basis through four integrated facilities in North America. These services and solutions support our customers' products from initial product development and design through manufacturing to worldwide distribution and aftermarket support. HEI uses the leverage created by its various technology platforms to provide bundled solutions to the markets served. In doing so, the Company uses much of its internal manufacturing capacity to create these solutions. For example, the "Link-it™ connectivity solution" uses flex circuitry, circuit board assembly, radio frequency ("RF"), software code and engineering services developed and delivered by our different internal capabilities. All of our facilities are ISO 9001:2000 certified.

In our Victoria, Minnesota facility we design and manufacture ultra miniature microelectronic devices and high technology products incorporating these devices. These custom microelectronic devices typically consist of placing or assembling one or more integrated circuits ("IC") commonly referred to as "chips," and other passive electrical components onto a ceramic or organic substrate. The microelectronic assembly typically embodies the primary functions of the end products of our customers, such as hearing aids, defibrillators and communication components. For example, in hearing aids the microelectronic assemblies we design and make are contained within a shell and connected to a microphone, receiver and battery. For some customers, we procure the microphone, receiver and battery from outside vendors and assemble all of the components into further assemblies; and we may sell only the microelectronic assembly to other customers. Our custom-built microelectronics are employed in the hearing, medical, telecommunications and ultra miniature radio frequency markets. Our microelectronics facilities achieved ISO 9001:2000 certification in August 2003.

Certain proprietary technology employed in our Victoria facility allows us to manufacture miniature packages that are specially designed to hold and protect high frequency chips for broadband communications. This package, with the enclosed chip, may then be easily and inexpensively attached to a circuit board without degrading the high-frequency performance of the chip. These packages, and the high-frequency chips that they contain, are specifically designed for applications in high-speed optical communication devices — the individual parts of the fiber-optic telecommunications network that companies and individuals use to transmit data, voice and video across both short and very long distances. We manufacture our products by fabricating a substrate and placing integrated circuits and passive electrical components onto that substrate. Substrates are made of multi-layer ceramic or laminate materials. The process of placing components onto the substrate is automated using sophisticated equipment that picks an IC from a wafer or waffle pack and places it onto a substrate with very high precision. Many of the components require wire bonding to electrically connect them to the substrate. We then electrically test the microelectronic assemblies to ensure required performance.

In our Boulder, Colorado facility we provide four primary products and services. First, we provide custom design and development outsourcing services for customers ranging from large medical device original equipment manufacturers ("OEMs") to emerging medical device companies worldwide. Our design and development projects generally include product concept definition, development of specifications for product features and functions, product engineering specifications, instrument design, development, prototype production and testing, and development of test specifications and procedures. We also perform various forms of verification and validation testing for software application and medical devices. We maintain a technical staff of engineers with backgrounds focused in electrical, mechanical, software and manufacturing disciplines. Second, Boulder's medical imaging group designs, develops and manufactures a broad range of advanced application software and major subsystem hardware. Our work includes the development of leading edge MRI software, cardiac and vascular diagnostic application software and high-density RF amplifier systems. Contracts in this business are undertaken with major OEMs in the medical imaging system market that integrate the power subsystems into their imaging systems. Third, we provide medical device manufacturing outsourcing services. We manufacture complex electronic and electromechanical medical devices. We are a registered device manufacturer with the Food and Drug Administration (the "FDA") and are required to meet the FDA's Quality System Regulation ("QSR"). This facility's quality system is certified to, and meets, ISO 9001:1994 and ISO 13485 standards. Our manufacturing projects include pre-production engineering and commercialization services, turnkey manufacturing of FDA Class I, Class II and Class III devices and system test services. Our manufacturing outsourcing services generally involve complex high-end devices, as opposed to commodity or high-volume products. In providing outsourcing services, we manufacture products for use in blood analysis, women's health therapies, and cancer detection systems. Fourth, Boulder provides a connectivity solution consisting of both hardware and software. This technology enables medical device Original

Equipment Manufactures (OEMs) and Health Care Information Technology (HCIT) vendors to add wired and wireless web server connectivity to their products quickly and cost-effectively.

Our Chanhassen, Minnesota facility manufactures wireless smart cards and other ultra-miniature RF applications. Ultra miniature electronic modules are connected to an RF coil, creating an assembly. This assembly is contained within a smart card or wireless card (about the same size as a credit card) that is used for financial, security access and identification or tacking applications.

In our Tempe, Arizona facility, we manufacture and design high density, high quality flex circuits and high-performance laminate-based substrates. We utilize specialized tooling strategies and advanced procedures to minimize circuit handling and ensure that consistent processing parameters are maintained throughout the assembly process. Significant portions of the substrates produced at this facility are transformed into custom-built microelectronics at our facility in Victoria, Minnesota.

Customers: We sell our products through our company-employed sales force based at our facilities in Minnesota, Arizona and Colorado, as well as through our independent sales representatives. In addition, we promote our services through industry advertising and exhibition at industry trade shows.

We currently have annual agreements with our three largest customers, Siemens, Inc., GN ReSound AS and GE Medical Systems ("GEMS"), a subsidiary of General Electric Company, along with several other customers. These agreements typically include basic understandings that relate to estimated needs of the customer, as well as a range of prices for the products for the current year. These agreements generally are cancelable by either party for any reason upon advanced notice given within a relatively short time period (eight to twelve weeks) and, upon such cancellation, the customer is liable only for any residual inventory purchased in accordance with the agreement. Although these annual agreements do not commit our customers to order specific quantities of products, they set the sale price and are useful as they enable us to forecast our customer's orders for the upcoming year.

Actual orders from our customers with whom we have annual agreements are made through customer supplied purchase orders ("POs"). POs specify quantity, price, product lead times, material and quality requirements and other general business terms and conditions. For customers with lower demand requirements we commonly use their POs only to plan production and procure materials. These programs are subject to our standard terms and conditions including cancellation clauses, whereby either party may cancel such POs for any reason upon advanced notice given within a relatively short time period.

Component Supply Operations: For all application specific or custom material, we try to match the quantities and terms related to the supply of such product of the customer and all major vendors. Although we prefer to have long-term agreements with our vendors, we do not currently have any long-term agreements with vendors in place. Typically, there are many sources of raw material supplies available nationally and internationally; however, many raw materials we use are customer specified and we are required to use customer specified vendors, or the customer supplies materials to us. The ICs that we assemble onto circuit boards are an example of a raw material that is commonly customer specified and available from specified vendors or supplied by the customer.

Proprietary Technology: We use proprietary technology and proprietary processes to incorporate such technology into many of our products. We protect this technology through patents, proprietary information agreements with our customers and vendors and non-disclosure agreements with substantially all of our employees. We have approximately 20 different inventions across the spectrum of our activities, which are either granted as patents or in some stage of active patent pursuit. We pursue new patentable technologies whenever practicable. We have a total of seven active and ten pending patents. Two of our most significant patents are the High Density Stacked Circuit Module and the Interconnection Device. The High Density Stacked Circuit Module is a method of stacking two or more ICs and then electrically interconnecting them. This approach allows us to use the thickness of the circuit to add capabilities rather than increase the width and length. The result is a more compact device than can be attained using conventional methods. The primary application is in our hearing market, where smaller circuits make it possible to fit more people with hearing aides and makes the hearing aid less obtrusive. Our latest design patent, the Interconnection Device, allows for the cost effective use of high-speed millimeter wave ICs by placing them into surface mount packages. These surface mount packages allow our customers to cost effectively incorporate those packages into their products, and also permits a rapid increase to high volume manufacturing, using standard high volume assembly equipment.

Government Regulations: Certain end products of our customers that we manufacture in our facilities are subject to federal governmental regulations (such as FDA regulations). The Boulder facility is a registered device manufacturer with the FDA. The Medical Device Amendments of 1976 to the Food, Drug and Cosmetic Act (the "FDC Act"), and regulations issued or proposed under the FDC Act, including the Safe Medical Devices Act of 1990, provide for regulation by the FDA of the marketing, design, manufacturing, labeling, packaging and distribution of medical devices. These regulations apply to products that are outsourced to us for manufacture, which include many of our customers' products, but not to our imaging and power generation products. The FDC Act and the regulations include requirements that manufacturers of medical products and devices register with, and furnish lists of products and devices manufactured by them, to the FDA. Prior to marketing a medical product or device, the company selling the product or device must obtain FDA clearance. Tests to be performed for approval range from bench-test data and engineering analysis to potentially expensive and time-consuming clinical trials. The types of tasks for a particular product submission are indicated by the classification of the device and previous approvals for similar devices. There are also certain requirements of other federal laws and of state, local and foreign governments, which may apply to the manufacture and marketing of our products. We are not directly subject to any governmental regulations or industry standards at our Victoria, Chanhassen and Tempe facilities. However, we are subject to certain industry standards in connection with our ISO 9001:2000 certification. Our products and manufacturing processes at such facilities are subject to customer review for compliance with such customer's specific requirements. The main purpose of such customer reviews is to assure manufacturing compliance with customer specifications and quality. All facilities are subject to local environmental regulations.

The FDA's Quality System Regulation for medical devices sets forth requirements for the design and manufacturing processes that require the maintenance of certain records and provide for unscheduled inspections of our Boulder facilities. The FDA reviewed our procedures and records during routine general inspections in 1995 and each year from 1997 to 2003.

Over 90 countries have adopted the ISO 9000 series of quality management and quality assurance standards. ISO standards require that a quality system be used to guide work to assure quality and to produce quality products and services. ISO 9001, the most comprehensive of the standards, covers 20 elements. These elements include management responsibility, design control, training, process control and servicing. ISO 9001 is the quality systems standard used by companies providing design, development, manufacturing, installation and servicing. The quality systems for our AMO are ISO 9001 and ISO 13485 certified, and our Victoria, Chanhassen, and Tempe facilities achieved ISO 9001:2000 certification in August 2003.

There are no material costs or expenses associated with our compliance with federal, state and local environmental laws. As a small generator of hazardous substances, we are subject to local governmental regulations relating to the storage, discharge, handling, emission, generation, manufacture and disposal of toxic or other hazardous substances, such as waste oil, acetone and alcohol that are used in very small quantities to manufacture our products. We are currently in compliance with these regulations and we have valid permits for the storage and disposal of the hazardous substances we generate. If we fail to comply with these regulations, substantial fines could be imposed on us and we could be required to suspend production, alter manufacturing processes or cease operations.

Dependence on Single or Few Customers and Backlog: The table below shows the percentage of our net sales to major customers that accounted for more than 10% of total net sales in our fiscal years ended August 31, 2003, 2002, and 2001.

Customer	Fiscal Years Ended August 31,		
	2003	2002	2001
Sonic Innovations, Inc.	17%	32%	26%
Siemens, Inc.	14%	32%	25%
GE Medical Systems	14%	—	—
Triquint Optoelectronics	—	—	10%

Sonic Innovations, Inc. and Siemens, Inc. operate in the human hearing-aid market. The decrease in percent of sales and sales dollars with both Sonic Innovations, Inc and Siemens, Inc. during our fiscal year ended August 31, 2003 ("Fiscal 2003"), is largely a result of their increased internal manufacturing capabilities and off shore out sourcing. GE Medical Systems, a subsidiary of General Electric Company, is a customer in the MRI component market of our Advanced Medical Operations and, although AMO was new to HEI in Fiscal 2003, GEMS was a customer of CMED during CMED's fiscal years ended June 30, 2003, 2002 and 2001. Triquint Optoelectronics is a customer in the communications market. Reduced revenue from Triquint Optoelectronics is attributed to the overall downturn in the telecommunications market. For financial information about revenues from external customers attributed to specific geographic areas see Item 8 — Note 17 to Consolidated Financial Statements.

The following table illustrates the approximate percentage of our net sales by market segment served.

Market	Fiscal Years Ended August 31,		
	2003	2002	2001
Medical/Hearing	82%	76%	61%
Communications	6%	11%	17%
RFID	8%	10%	14%
Other	4%	3%	8%

We believe that diversification between our key markets is important. Our goals are to have no one market account for 40% or more of our net sales, no one customer greater than 25% of net sales and no one program exceeding 10% of net sales. Our plans to achieve our goals include increasing our product offerings, customer base and programs to increase revenue, which will result in more diversification.

At August 31, 2003, our backlog of orders for revenue for our fiscal year ending August 31, 2004 ("Fiscal 2004") was approximately $18,645 compared to approximately $5,400 at August 31, 2002. We expect to ship our backlog as of August 31, 2003, during Fiscal 2004. This increase in backlog is mainly due to increased order activity from the overall stronger economic conditions in our markets and $10,864 from the acquisition of AMO.

Competition: In each of our product lines, we face significant competition, including customers who may produce the same or similar products themselves. Our competitive advantage starts with knowledge of the market requirements and our investment in technology to meet those demands. We use proprietary technology and proprietary processes to create unique solutions for our customers' product development and manufacturing requirements. We believe that customers engage HEI because they view us to be the leading edge in designing and manufacturing products that help them, in turn, delivering better products faster and cheaper than they could do by themselves. Finally, we compete on the basis of full service to obtain new and repeat orders. We are a full-service supplier and partner with our customers, providing full "turn-key" capability.

Research and Development: The amount that we spent on company-sponsored research and development activities aggregated approximately $2,580, $2,516 and $2,433 for our fiscal years ended August 31, 2003, 2002 and 2001, respectively.

Employees: On August 31, 2003, we employed 284 full-time persons and 1 part-time person.

Item 2. ***Properties.***

We own a 48,000 square foot facility for administration and microelectronics production in Victoria, Minnesota, a suburb of Minneapolis, which was originally built in August 1981. The facility was expanded during our fiscal year ended August 31, 1996 from the original 25,000 square feet with an addition of 23,000 square feet to increase production capacity. The addition was financed through the issuance of Industrial Development Revenue Bonds ("IDRBs") with the City of Victoria on the property and certain equipment. On March 14, 2003, the outstanding principal and interest on these IDRBs were paid from the proceeds of the subordinated promissory note issued to CMED in connection with the acquisition of our AMO (the "Subordinated Promissory Note") In October 2003, the Company completed a $1,200 financing that is secured with a mortgage on the Victoria, Minnesota facility.

We lease a 14,000 square foot facility in Tempe, Arizona for our high density interconnect business. We lease two properties in Minnesota: a 20,000 square foot facility in Chanhassen, Minnesota, for part of our RFID business, and a 3,100 square foot facility in Eden Prairie, Minnesota, that was formerly used for corporate offices. In April 2003, we re-located our corporate offices to our Victoria facility and sub-leased the Eden Prairie facility The Tempe and Chanhassen facilities are leased until July 2005 and June 2012, respectively, and the Eden Prairie facility is leased until March 2005.

We lease a 150,022 square foot facility in Boulder, Colorado for our Advanced Medical Operations. The Boulder facility is leased until April 2013. As a part of the purchase accounting for the acquisition of our AMO, HEI has established a $3,110 reserve related to the future estimated lease payments of the Boulder facility, which is currently not being fully utilized. In addition, we intend to reduce our occupancy costs at this facility by sub-leasing the 50,000 square foot addition.

Item 3. ***Legal Proceedings.***

On June 30, 2003, we commenced litigation against Anthony J. Fant, our former Chairman of the Board, Chief Executive Officer and President and a current director, in the State of Minnesota, Hennepin County District Court, Fourth Judicial District. The complaint alleged breach of contract, conversion, breach of fiduciary duty, unjust enrichment and corporate waste resulting from, among other things, Mr. Fant's default on his promissory note to us and other loans and certain other matters. On August 12, 2003, we obtained a judgment against Mr. Fant on our breach of contract count in the amount of approximately $606. On August 12, 2003, the Court did not rule on the other counts in the complaint, reserving to a later time such determination. On November 24, 2003, the Court granted us an additional judgment against Mr. Fant in the amount of approximately $993 on the basis of our conversion, breach of fiduciary duty, unjust enrichment and corporate waste claims. We are engaged in efforts to collect on the judgment and plan to continue to collect on the judgment in due course. We have obtained, through garnishments, in excess of approximately $112 from Mr. Fant's accounts. Such amount partially reduces the judgment amount. We continue to seek to collect on the remaining judgment amount in Minnesota and other states where it is believed that Mr. Fant may have non-exempt and unencumbered assets.

Item 4. ***Submission of Matters to a Vote of Security-Holders***

There were no matters submitted to a vote of shareholders during the fourth quarter of our fiscal year ended August 31, 2003.

Executive Officers of the Registrant

The following is a list of our executive officers, their ages and offices as of December 16, 2003. Each executive officer serves a term of one year or until his successor is appointed and qualified.

Name	Age	Position
Mack V. Traynor, III	45	Chief Executive Officer and President
Douglas J. Nesbit	51	Chief Financial Officer
Stephen K. Petersen	51	Vice President of the Micro Electronics Operation
Scott M. Stole	40	Chief Technical Officer
Simon F. Hawksworth	37	Vice President of Sales and Marketing
James C. Vetricek	46	Vice President of the Advanced Medical Operation

Mack V. Traynor, III has served as our Chief Executive Officer and President since March 2003, and has served on our Board of Directors since 1998. Mr. Traynor currently serves as President of Manitou Investments, a private investment and business management firm, a position he has held since 1998. Although Mr. Traynor currently serves in such capacity with Manitou Investments, he devotes substantially all of his efforts to his duties and responsibilities at the Company. Since June 2003, Mr. Traynor has served on the Board of Directors of ACT Telecommunications (NASDAQ: ACTT), an international teleconferencing service provider. Previously, Mr. Traynor served as President and Chief Executive Officer of Supreme Companies, Inc., a privately held landscape and grounds maintenance company, from February 2002 to September 2003. Mr. Traynor also previously served as Chief Executive Officer of Do The Good, Inc., a philanthropic software development company, from May 2001 until October 2001, and as Chief Financial Officer of 10K Partners, Inc., private investment company, from April 2000 until June 2000. Mr. Traynor served as President and Chief Executive Officer of NeoNetworks, a privately-held development stage company designing high-speed data communications equipment, from October 1998 to April 2000. Mr. Traynor was a director of Telident, Inc., a publicly-held telecommunications products and services company, from 1998 to 2000. Mr. Traynor also served as a director of Eltrax Systems, Inc., a publicly-held networking products and services company, from 1995 to 1999, serving as Chief Financial Officer from 1995 to 1996 and President, Chief Executive Officer and Chief Operating Officer from 1995 to 1997. Mr. Traynor served as President and Chief Operating Officer of Military Communications Center, Inc., a company that provided telecommunications services to U.S. Military personnel, from 1988 to 1995. He also served as President of U.S. West Enterprises, a division of U.S. West, Inc.

Douglas J. Nesbit has served as our Chief Financial Officer since June 2003. Prior to joining HEI, Mr. Nesbit served as the Chief Financial Officer, Secretary and Treasurer of LecTec Corporation, a publicly-held consumer health care company, from 2000 to 2003, as the Corporate Treasurer at Secure Computing Corporation, a provider of computing system security tools and devices, from 1997 to 2000, and as Corporate Controller of ValueRX, a pharmacy benefit management firm, from 1996 to 1997. Mr. Nesbit's professional background also includes public accounting experience with the big four firm of KPMG LLP. Mr. Nesbit also serves as a Director of the Minnesota Society of Certified Public Accountants and a participant on the CPE advisory committee for the AICPA.

Stephen K. Petersen Vice President of the Micro Electronics Operation joined us in March 1998 as Director of Manufacturing. He was appointed Vice President of Operations in September 2000. Before joining us, he was employed with Sheldahl, a manufacturer of electronic materials and derivatives, in a variety of positions ranging from Engineer to Plant Manager and most recently as the Operations Manager. Mr. Petersen was responsible for production and manufacturing engineering departments.

Scott M. Stole Ph.D. joined us in October 2000 as Director of Advanced Process Development. In June 2003, he was promoted to Chief Technical Officer. Prior to joining HEI, Dr. Stole served as President & CEO of Questek Innovations, Inc., a developer of advanced hardware technologies for the disk drive industry, from May 1997 to October 2000, where he oversaw technology development, intellectual property protection, corporate strategy and strategic alliances. Dr. Stole received his Ph.D. from Iowa State University and his Bachelors degree from Concordia College, and has 13 years of experience in the design, development and manufacture of a wide range of microelectronics and advanced materials-related products.

Simon F. Hawksworth joined us in September 2002 as Vice President of Sales and Marketing. Prior to joining us, he served as Vice President of Sales and Marketing at InnovaComm Technologies, Inc, a microelectronics manufacturing company and a spin-off of Maxtek, a wholly-owned subsidiary of Tektronix, from February 2000 to August 2002. Mr. Hawksworth also served, from August 1998 to August 2002, in a variety of positions at Maxtek from Business Development Manager through Director and Vice President of Sales and Marketing. Prior to joining us, Mr. Hawksworth's positions focused on winning new business requiring high frequency electronics packaging solutions.

James C. Vetricek joined us in January 2003 in connection with our acquisition of our AMO as Vice President of our AMO. Prior to such acquisition, Mr. Vetricek served as Vice President, Quality and Regulatory Affairs of CMED from February 2001 to January 2003. Mr. Vetricek has over 20 years of experience as a medical device professional managing facilities with multi-site operations. His responsibilities have included research and development, regulatory affairs, pilot manufacturing, and proprietary and contract manufacturing operations. Mr. Vetricek's product experience includes sterile single use devices, implants, bio absorbable surgical materials, electromechanical surgical systems, anesthesia systems and cardiovascular monitoring devices. Prior to joining CMED, he served as Vice President of Regulatory Affairs & Quality Management at Linvatec, a division of Conmed a medical equipment manufacturer from February 1999 to February 2001. Mr. Vetricek also serve from September 1994 to June 1998 as Vice President of Regulatory Affairs & Quality Assurance and R&D at Ohmeda Medical Device, a division of BOC Group an industrial producer of gases.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

MJK CLEARING, INC.,

Debtor.

Adv. Proc. No. 01-4257

James P. Stephenson, in his capacity as Trustee for the Estate of MJK Clearing, Inc.,

Plaintiff,

v.

Kyla Fant,

Defendant.

Adv. Proc. No. 04-4165

AFFIDAVIT OF PERSONAL SERVICE

STATE OF MINNESOTA)
) ss.
COUNTY OF HENNEPIN)

Adam Oliansky of the City of Minneapolis, County of Hennepin, in the State of Minnesota, being duly sworn, says that on the 28th day of October, 2004, he served the Plaintiff's Response to Defendant's Motion to Dismiss, Transfer or Abstain and Affidavit of Trustee on the following attorney by handing to and leaving with Kristina Solomon personally, 1 true and correct copy thereof, at the following address(es):

Norman I. Taple
Wagner, Falconer & Judd, Ltd.
3500 IDS Center
80 South Eighth Street
Minneapolis, MN 55402

Adam Olianky

Subscribed and sworn to before me
this 28th day of October, 2004.

Sharon M. Johnston
Notary Public

SHARON M. JOHNSTON
Notary Public
Minnesota
My Commission Expires Jan. 31, 20__

Completed Affidavit of Service should be returned to S. Johnston/24th Floor.