

RIMAGE CORP  
Form 10-K  
March 15, 2006

**FORM 10-K**  
**U.S. SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

COMMISSION FILE NO. 0-20728

**RIMAGE CORPORATION**

(Exact name of registrant as specified in its charter)

**Minnesota**

State or other jurisdiction of  
incorporation or organization

**41-1577970**

(I.R.S. Employer  
Identification No.)

**7725 Washington Avenue South, Minneapolis, Minnesota**

(Address of principal executive offices)

**55439**

(Zip Code)

Registrant's telephone number:

**(952) 944 - 8144**

Securities registered pursuant to Section 12(b) of the Act:

**None**

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, \$.01 par value**

**Preferred Stock Purchase Rights**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. **Yes o No x**

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. **Yes o No x**

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 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 x No o**

Indicate by checkmark 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. **o**

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

**Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o**

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Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

**Yes o No x**

The aggregate market value of common stock held by non-affiliates of the registrant, computed by reference to the last quoted price at which such stock was sold on such date as reported by the Nasdaq Stock Market as of the last business day of the registrant's most recently completed second fiscal quarter was approximately \$201,800,000.

As of February 28, 2006, 9,650,233 shares of the registrant's common stock were outstanding.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for its 2006 Annual Meeting of Shareholders, to be filed within 120 days after the end of the fiscal year covered by this report, are incorporated by reference into Part III hereof.

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**General Information**

**PART I**

**ITEM 1. BUSINESS**

**General**

Rimage Corporation ( Rimage ) is a leading provider of CD recordable ( CD-R ) and DVD recordable ( DVD-R ) publishing systems required for producing discs with customized digital content on an on-demand basis. Rimage s publishing systems, which include equipment to handle a full range of low-to-high production volumes, incorporate robotics, software and custom printing technology for disc labeling. Rimage focuses its CD-R and DVD-R publishing solutions on a set of vertical markets with special needs for customized, on-demand digital information, including digital photography, medical imaging, banking and finance, government, and business offices.

Incorporated as IXI, Inc. in Minnesota in February 1987, Rimage has focused on digital storage production equipment since its inception. From 1987 until the introduction of its first CD-R production equipment in 1995, most of Rimage s products consisted of diskette and tape duplication equipment. Rimage also generated a significant portion of its revenue from CD-ROM and diskette duplication and production services from 1993 until 1999. From 1994 to 1997, Rimage also engaged in other lines of business, including development of browser and archiving software and distribution of CD-ROM stamping presses.

Since 1995, Rimage has focused its business on development and sale of its CD-R publishing systems, and since 2000, its DVD-R publishing systems. In 1997, Rimage ceased distribution activities for CD-ROM stamping presses and terminated browser and archiving software development. During the third quarter of 1998, Rimage ceased operations of its Minnesota services business and sold the equipment and inventory associated with that business. On June 30, 1999, Rimage ceased operations of its Colorado services business and sold all the assets associated with that business. The resources previously applied to these businesses were instead applied to development and sales of CD-R and DVD-R products for commercial applications.

On March 1, 2000, Rimage acquired Cedar Technologies, Inc. ( Cedar ) and issued 497,496 shares of its common stock for all of the outstanding shares of Cedar. Cedar had developed and manufactured CD-R publishing and duplication equipment for desktop applications that sold at a lower price point than the higher volume systems sold by Rimage. Cedar products formed the basis for the introduction of Rimage s desktop line of products.

**Products**

Rimage s products are designed to enable the automation of data distribution and archiving processes. In some cases this results in a reduction of labor and training costs for users of the products, in other cases it enables totally new and innovative applications. Rimage products provide compelling solutions for distribution and archiving of information on CDs and DVDs for just-in-time, on-demand and mass customization applications.

The principal benefits to users of Rimage s products include unattended operation, reduced labor costs, higher throughput than alternative systems and higher quality. One of the essential elements of Rimage s marketing and development is to provide users with a path for future product upgrades for improved products or products with additional capabilities, such as drives with faster recording speeds. Rimage has made a long-term commitment to its customers by providing maintenance service contracts, replacement parts and repair service to customers for current, as well as past products.

Sales of CD-R/DVD-R production equipment comprised 62% of Rimage s revenue from operations during both 2005 and 2004, and 70% in 2003. Rimage s other major sources of revenue are recurring in nature and consist of consumables (ribbons, ink cartridges and Rimage-branded blank CD-R and DVD-R media), parts and maintenance contract sales.

Since the acquisition of Cedar, Rimage s CD-R and DVD-R hardware products have been divided into two primary product lines: the Producer line of equipment for higher volume CD-R and DVD-R production requirements, and the Desktop line of lower-cost products for office and other desktop applications. The Producer line of products continues to generate the majority of Rimage s revenue, comprising 51% of total revenues in both 2005 and 2004, at \$48,428,000 and \$36,186,000, respectively. The Desktop line contributed 11% to total revenues each year, at \$10,692,000 in 2005 and \$7,887,000 in 2004. The balance of revenue in each year was generated through sale of

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Rimage-branded blank CD-R/DVD-R media, ribbons, ink cartridges, parts, repair services and maintenance contracts. Such recurring revenues comprised 38% of total revenue in both 2005 and 2004, at \$36,290,000 and \$26,775,000, respectively. The growth in recurring revenues has been spurred by the expansion of the Company's worldwide installed base of CD-R/DVD-R publishing systems as well as the Company's introduction in 2004 of its new consumable supplies strategy involving media kits. Through this strategy, the Company assembles Rimage-branded blank CD-R and DVD-R discs with replacement printer ribbons and cartridges into kits to simplify the customer's purchase and use of these consumable products in the production process.

**The Producer II Series.** The Producer II Series of CD-R/DVD-R publishing systems represents the current generation of the Producer line and consists of a family of products that cover a broad range of applications for the publishing and duplication of CD-R's and DVD-R's. Each Producer II product incorporates CD-R or DVD-R recorders, or both, with customized robotics, a thermal or thermal re-transfer printer for on-disc color printing, software, and computer hardware components.

Rimage offers its Producer II line of products in four basic configurations to meet the varying needs of its commercial customers. The Autostar II provides industry leading speed and throughput for on-demand CD-R/DVD-R production, utilizing up to four simultaneous data streams. The Autostar II can contain any combination of CD-R/DVD-R recorders and provides for a capacity of 300 discs. The Protégé II system comes standard with two CD-R recorders that may be interchanged with DVD-R recorders and the Amigo II comes with one recorder. The Autostar II, Protégé II and Amigo II are all available with either Rimage's Everest or Prism printers. The DiscLab system was introduced in 2004, replacing its predecessor, the Endeavor. Designed as a network attached publishing system, the DiscLab features an embedded host PC, two CD-R or DVD-R recorders, an Everest printer and a small product size and footprint. The markets served by Rimage's Producer line of products include the digital photography, medical, banking and government industries. Prices of the Producer II line of products range from \$10,000 to \$30,000.

The Everest printer was developed to meet the need of customers for an on-demand surface printer able to produce color and monochrome labels with quality similar to offset and silkscreen printing systems. Everest produces images on CD-R and DVD-R media that are indelible and cover the full surface of the media. Rimage's Prism Printer provides high-speed, laser quality monochrome and spot color printing on standard CD-R/DVD-R media for in-house, customized printing. The Producer line also includes Autoprinters that incorporate either an Everest or Prism printer.

**The Desktop Series.** Originally established through the acquisition of Cedar Technologies, Inc., Rimage's Desktop Series of CD-R/DVD-R products features economical pricing, a compact desktop design, software, network compatibility and stand-alone, plug-and-play technology ideal for office environments. The Desktop line of products offers a two-drive recorder unit. In June 2004, the Company introduced the Rimage 2000i Desktop publishing system and Rimage 480i thermal inkjet printer. Co-developed by the Company and Hewlett-Packard, the Rimage 480i inkjet printer features 4800 dpi resolution for high clarity color printing on CD-R/DVD-R discs. In April 2005, the Company introduced its lowest cost Desktop product, the Rimage 360i, which also uses the Company's proprietary thermal inkjet printing technology.

### Marketing and Distribution

Rimage currently utilizes the following principal means of distributing its products: Direct sales using its own sales force, primarily in Europe; a two tier distribution system of distributors to value added resellers in Europe, the U.S. and Latin America; and a distributor to end-user system in Asia Pacific and in some areas in Europe. Rimage's channel partners, primarily consisting of distributors, value added resellers and other strategic partners, currently generate the majority of the Company's sales.

Rimage has historically focused its sales and marketing efforts on high-volume CD-R and DVD-R publishing solutions for its Producer product line in such areas as banking and finance and wholesale photo processing labs. Rimage plans to continue to expand its position in many of its traditional markets. Additionally, Rimage is focusing on new applications with high-growth potential in retail photography, medical imaging and business services. This has led to the expansion of the Company's sales and marketing organization to help penetrate these targeted markets and strengthen marketing support for new products.

During 2005 and 2004, Rimage derived 12% and 13% of its respective revenues from one of its distributors, and 11% and 12% of its respective revenues from a strategic partner. Two distributors generated more than 10% of revenues in 2003, at 16% and 12% of revenues, respectively.

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Rimage conducts foreign sales through its U.S. operation and its subsidiaries in Germany and Japan, Rimage Europe GmbH, and Rimage Japan, respectively. Foreign sales constituted approximately 34%, 38% and 42% of Rimage's revenue for the years ended December 31, 2005, 2004, and 2003, respectively.

### Competition

Rimage competes with a number of manufacturers of CD-R/DVD-R production equipment and related products. Primary competitors of the Company currently include Primera Technology, Inc., Microtech Systems, Inc. and LSK Data Systems GmbH. Rimage is able to compete effectively in the sale of CD-R/DVD-R production equipment because of technological leadership in automated solutions and its early start within the CD-R/DVD-R production equipment industry. Rimage believes that its quality printing capabilities for CD-R/DVD-R, its transporter mechanisms and its software differentiate its products from those of competitors. Rimage also competes with alternative technologies in the storage media industry such as high capacity hard drives, flash memory, new CD-R/DVD-R technologies, file servers accessible through computer networks and the Internet, and additional media is under development. Rimage believes its technology has advantages over these alternative technologies in terms of reliability, performance, cost and ease of use.

### Manufacturing

Rimage's manufacturing operations consist primarily of the assembly of products from components purchased from third parties. Some parts are standard components and others are manufactured to Rimage's specifications. Rimage's employees at its facility in Edina, Minnesota conduct assembly and testing operations. Components include CD-R/DVD-R drives, circuit boards, electric motors, machined and molded parts, precision sheet metal assemblies, and other mechanical parts.

Although Rimage believes it has identified alternative assembly contractors for most of its subassemblies, an actual change in such contractors would likely require a period of training and testing. Accordingly, a sudden interruption in a supply relationship or the production capacity of one or more of such contractors could result in Rimage's inability to deliver one or more products for a period of several months.

### Research and Development

At December 31, 2005, 35 employees were involved in research and development at Rimage. This staff, with software, electrical, mechanical and drafting capabilities, engages in research and development of new products, and development of enhancements to existing products.

The industries served by Rimage are subject to rapid technological changes. Alternate data storage media exist or are under development, including high capacity hard drives, new CD-R/DVD-R technologies, file servers accessible through computer networks, and the Internet. All these forces may affect the usage of CD-R and DVD-R media. Rimage believes that it must continue to innovate and anticipate advances in the storage media industry in order to remain competitive.

Rimage's expenditures for research and development were \$5,512,000, \$4,530,000 and \$3,765,000 in 2005, 2004 and 2003, representing 5.8%, 6.4% and 7% of revenues, respectively. Rimage anticipates its expenditures in research and development will approximate 7% to 8% of revenues during 2006.

### Patents and Government Regulation

Rimage currently maintains eleven U.S. and foreign patents and has a total of nineteen U.S. and foreign patents pending. In addition, Rimage protects the proprietary nature of its software primarily through copyright and license agreements and through close integration with its hardware offerings. It is Rimage's policy to protect the proprietary nature of its new product developments whenever they are likely to become significant sources of revenue. No guarantee can be given that Rimage will be able to obtain patent or other protection for its products.

As the number of Rimage's products increase and the functionality of those products expands, Rimage believes that it may become increasingly subject to attempts by others to duplicate its proprietary technology and to the possibility of infringement of Rimage patents. In addition, although Rimage does not believe that any of its products infringe the rights of others, third parties have claimed, and may in the future claim, Rimage's products infringe on their rights and these third parties may assert infringement claims against Rimage in the future. Rimage may litigate such infringement claims or settle such claims through license or other royalty arrangements.

Rimage is currently working to move its product portfolio into full compliance with the European Union Restriction of Hazardous Substances Directive, which restricts the use of certain hazardous substances in electrical and

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electronic equipment. Rimage has retained an external consulting firm to guide its efforts in this compliance project. Rimage expects that its products will be in full compliance with this directive by July 1, 2006, the beginning of compliance enforcement.

The FCC requires some of Rimage's equipment meet radio frequency emission standards. Rimage takes steps to ensure proper compliance of all products.

### Employees

At December 31, 2005, Rimage had 208 full-time employees, of which 35 were involved in research and development, 93 in assembly, testing, repair and customer service, and 80 in sales, marketing, administration and management. None of Rimage's employees are represented by a labor union or covered by a collective bargaining agreement.

### Cautionary Note Regarding Forward-Looking Statements

We make written and oral statements from time to time regarding our business and prospects, such as projections of future performance, statements of management's plans and objectives, forecasts of market trends, and other matters that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements containing the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimates," "projects," "believes," "expects," "anticipates," "intends," "plans," "objective," "should" or similar expressions identify forward-looking statements, which may appear in documents, reports, filings with the Securities and Exchange Commission, news releases, written or oral presentations made by our authorized officers or other representatives. For such statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Our future results, including results related to forward-looking statements, involve a number of risks and uncertainties. No assurance can be given that the results reflected in any forward-looking statements will be achieved. Any forward-looking statement made by or on behalf of us speaks only as of the date on which such statement is made. We do not undertake any obligation to update or keep current any forward-looking statement to reflect events or circumstances arising after the date of such statement.

In addition to other matters identified or described by us from time to time in filings with the SEC, there are several important factors that could cause our future results to differ materially from historical results or trends, results anticipated or planned by us, or results that are reflected from time to time in any forward-looking statement that may be made by or on behalf of us. These important factors are described below under Item 1A. Risk Factors.

### **ITEM 1A. RISK FACTORS**

If any of the following risks actually occur, our results of operations, cash flows and the market price of our common stock could be negatively impacted. Although we believe that we have identified and discussed below the key risk factors affecting our business, there may be additional risks and uncertainties that are not presently known or that are not currently believed to be significant that may adversely affect our performance or financial condition.

#### **Technology in our industry evolves rapidly, potentially causing our products to become obsolete, and we must continue to enhance existing systems and develop new systems or we will lose sales.**

Rapid technological advances, rapidly changing customer requirements and fluctuations in demand characterize the current market for our products. Further, there are alternative data storage media and additional media is under development, including high capacity hard drives, flash memory, new CD-R/DVD-R technologies, file servers accessible through computer networks and the Internet. Our existing and development-stage products may become obsolete if our competitors introduce newer or more appealing technologies. If these technologies are patented or proprietary to our competitors, we may not be able to access these technologies. We believe that we must continue to innovate and anticipate advances in the storage media industry in order to remain competitive. If we fail to anticipate or respond to technological developments or customer requirements, or if we are significantly delayed in developing and introducing products, our business will suffer lost sales.

**Our market is becoming more competitive. Competition may result in price reductions, lower gross profits and loss of market share.**

The storage media industry is becoming more competitive and we face the potential for increased competition in developing and selling our CD-R and DVD-R publishing systems in both the U.S. and in foreign markets. Our competitors may have or could develop or acquire significant marketing, financial, development and personnel resources. Our current primary competitors include Primera Technology, Inc., Microtech Systems, Inc. and LSK Data Systems GmbH. To remain competitive, we believe that we must continue to provide:

- § technologically advanced systems that satisfy the demands of end-users;
- § continuing advancements in our CD-R and DVD-R products;
- § a dependable and efficient distribution and reseller network;
- § superior customer service; and
- § high levels of quality and reliability.

We cannot assure you that we will be able to compete successfully against our current or future competitors. The storage media industry has increased visibility, which may lead to large, well-known, well-financed companies entering into this market. Increased competition from manufacturers of systems or consumable supplies may result in price reductions, lower gross profit margins, increased discounts to distribution and loss of market share and could require increased spending by us on research and development, sales and marketing and customer support.

**If our products fail to compete successfully with other existing publishing systems or newly-developed products for the storage media industry, our business will suffer.**

The success of our products depends upon our end users choosing our CD-R and DVD-R technology for their storage media needs. However, alternative data storage media exist, such as high capacity hard drives, flash memory, new CD-R/DVD-R technologies, file servers accessible through computer networks and the Internet, and additional media is under development. If end users perceive any technology that is competing with ours as more reliable, higher performing, less expensive or having other advantages over our technology, the demand for our CD-R and DVD-R products could decrease. Further, some of our competitors may make strategic acquisitions or establish cooperative relationships with suppliers or companies that produce complementary products such as cameras, computer equipment, software or biometric applications. Competition from other publishing systems or other storage media is likely to increase. If our products do not compete successfully with existing or new competitive products, our business will suffer.

**We sell a significant portion of our products internationally, which exposes us to risks associated with foreign operations.**

We sell a significant amount of our products to customers outside the United States, particularly in Europe, Asia and Latin America. International sales accounted for 34%, 38% and 42% of our revenue for the years ended December 31, 2005, 2004 and 2003, respectively. We expect that shipments to international customers, including customers in Europe, Asia and Latin America, will continue to account for a significant portion of our net sales. Sales outside the United States involve the following risks, among others:

- § foreign governments may impose tariffs, quotas and taxes;
- § the demand for our products will depend, in part, on local economic health;
- § political and economic instability may reduce demand for our products;
- § restrictions on the export or import of technology may reduce or eliminate our ability to sell in certain markets;
- § potentially limited intellectual property protection in certain countries may limit our recourse against infringing products or cause us to refrain from selling in certain markets;
- § we may face difficulties in managing our international operations;
- § the burden and cost of complying with a variety of foreign laws;
- § we may decide to price our products in foreign currency denominations;
- § our contracts with foreign distributors and resellers cannot fully protect us against political and economic instability;
- § we may face difficulties in collecting receivables; and
- § we may not be able to control our international distributors' efforts on our behalf.



The financial results of our German and Japanese subsidiaries are translated into U.S. dollars for consolidation with our overall financial results. Additionally, we hedge against currency fluctuations associated with foreign currency denominated transactions (principally European Euro) with Rimage Europe. Despite our hedging activity, currency translations and fluctuations may adversely affect the financial performance of our consolidated operations. Currency fluctuations also may increase the relative price of our product in foreign markets and thereby could also cause our products to become less affordable or less price competitive than those of foreign manufacturers. These risks associated with foreign operations may have a material adverse effect on our revenue from or costs associated with international sales.

**If our domestic or international intellectual property rights are not adequately protected, others may offer products similar to ours which could depress our product selling prices and gross profit margins or result in loss of market share.**

We believe that protecting our proprietary technology is important to our success and competitive positioning. In addition to common law intellectual property rights, we rely on patents, trade secrets, trademarks, copyrights, know-how, license agreements and contractual provisions to establish and protect our intellectual property rights. However, these legal means afford us only limited protection and may not adequately protect our rights or remedies to gain or keep any advantages we may have over our competitors.

**We cannot assure you that others may not independently develop the same or similar technologies or otherwise obtain access to our technology and trade secrets. Our competitors, who may have or could develop or acquire significant resources, may make substantial investments in competing technologies, may apply for and obtain patents that will prevent, limit, or interfere with our ability to manufacture or market our products. Further, although we do not believe that any of our products infringe the rights of others, third parties have claimed, and may in the future claim, our products infringe on their rights and these third parties may assert infringement claims against us in the future.**

Costly litigation may be necessary to enforce patents issued to us, to protect trade secrets or know-how we own, to defend us against claimed infringement of the rights of others or to determine the ownership, scope, or validity of our proprietary rights and the rights of others. Any claim of infringement against us may involve significant liabilities to third parties, could require us to seek licenses from third parties, and could prevent us from manufacturing, selling, or using our products. The occurrence of this litigation, or the effect of an adverse determination in any of this type of litigation, could have a material adverse effect on our business, financial condition and results of operations. Further, the laws of some of the countries in which our systems are or may be sold may not protect our systems and intellectual property to the same extent as the United States or at all. Our failure to protect or enforce our intellectual property rights could have a material adverse effect on our business, results of operations and financial condition.

**Our sales will decline and our business will be materially harmed if our key channel partners do not effectively market or sell our products or if there is a significant reduction, delay or cancellation of orders from such channel partners or our direct OEM customers.**

We distribute our products to end users through our own sales force, through distributors and through a two-tier system of distributors and resellers. Although certain distributors and resellers have made certain contractual commitments to us, they are independent businesses that we do not control. We cannot be certain that our distribution channel will continue to market or sell our systems effectively. Our agreements with distributors and resellers do not contain requirements that a certain percentage of such parties' sales are of our products nor do the agreements restrict their ability to choose alternative sources for CD-R or DVD-R publishing systems.

During 2005 and 2004, we derived approximately 12% and 13% of our respective revenues from a single distributor, and 11% and 12% of respective revenues from a strategic partner. Two of our distributors generated more than 10% of revenues in 2003, at 16% and 12% of revenues, respectively. A significant reduction, delay or cancellation of orders from our key channel partners or our direct OEM customers, or the loss of any of them, could have a negative impact upon our operating results. Further, some of our channel partners are small organizations with limited capital and our success in distributing our products to end-users will depend upon the continued viability and financial stability of these entities. These channel partners may choose to devote their efforts to other products in different markets or reduce or fail to devote the necessary resources to provide effective sales and marketing support of our product. We believe that our future growth and success will continue to depend in large part upon the success of our channel partners in operating their businesses and our relationships with our direct OEM customers.

**If we do not maintain adequate inventories of component parts or finished goods or if we fail to adequately forecast demand, the likely resulting delays in producing our publishing systems products would damage our business.**

Because most of our systems are built upon order, we do not maintain a significant inventory of completed systems. We assemble the Producer II Series and Desktop Series systems as they are ordered, which causes us to forecast production based on past sales and our estimates of future demand. In the event that we significantly underestimate our needs or encounter an unexpectedly high level of demand for our systems or our suppliers are unable to deliver our orders of components in a timely manner, we may be unable to fill our product orders on time which could harm our reputation and result in reduced sales.

**We rely on single-source suppliers, which could cause delays, increases in costs or prevent us from completing customer orders, all of which could materially harm our business.**

We assemble our Producer II Series and Desktop Series products using materials and components supplied by various subcontractors and suppliers. We purchase critical components for our systems, including CD-R/DVD-R drives, circuit boards, electric motors, machined and molded parts, precision sheet metal assemblies and mechanical parts, from third parties, some of whom are single-source suppliers of these components. If any of our suppliers is unable to ship critical components, we would be unable to manufacture and ship products to our end-users, distributors or resellers. If the price of these components increases for any reason, or if these suppliers are unable or unwilling to deliver, we may have to find another source, which could result in interruptions, increased costs, delays, loss of sales and quality control problems.

The termination or interruption of any of these relationships, or the failure of these manufacturers or suppliers to supply products or components to us on a timely basis or in sufficient quantities, likely would cause us to be unable to meet orders for our products and harm our reputation and our business. Identifying and qualifying alternative suppliers of components would take time, involve significant additional costs and may delay the production of our products. Further, if we obtain a new supplier for a component or assemble our product using an alternative component, we may need to conduct additional testing of our products to ensure the product meets our quality and performance standards. Any delays in delivery of our product to end-users, distributors or resellers could be extended and our costs associated with the change in product manufacturing could increase.

The failure of our third-party manufacturers to manufacture the products for us, and the failure of our components suppliers to supply us with the components, consistent with our requirements as to quality, quantity and timeliness could materially harm our business by causing delays, loss of sales, increases in costs and lower gross profit margins.

**Our products must be compatible with products designed and manufactured by others and, in the event of design changes or the introduction of new products by them or us, our products must continue to be compatible with products of others.**

Our Producer II Series and Desktop Series of our CD-R/DVD-R publishing systems incorporate computer and related computer equipment, hardware and software manufactured by others. Our products are designed to provide end users with a fully-integrated publishing system and therefore, our products must operate with the computer and related equipment of others to function properly for end users. Problems with the products of others may adversely affect the performance and reliability of our publishing system products and damage our reputation with end users. Further, if there are changes in our products, changes in the computer or computer related equipment integrated into our products or if we offer new products, we must maintain compatibility and interoperability of our products with the products of others. We cannot assure you that we will be able to adapt our products to be compatible with any newly designed product of another party. We would likely incur substantial costs to test and de-bug any newly designed product that we integrate into our products. Further, our new product development efforts may be hampered by our need to maintain compatibility with the products of others and we may incur additional expense designing for compatibility.

**Our publishing systems may have manufacturing or design defects that we discover after shipment, which could negatively affect our revenues, increase our costs and harm our reputation.**

Our publishing systems are complex and may contain undetected and unexpected defects, errors or failures. If these product defects are substantial, the result could be product recalls, an increased amount of product returns, loss of market acceptance and damage to our reputation, all of which could increase our costs and cause us to lose sales. We carry general commercial liability insurance covering our products with policy limits per occurrence and in the aggregate that we have deemed to be sufficient. We cannot predict, however, whether this insurance is sufficient, or if not, whether we will be able to obtain sufficient insurance to cover the risks associated with our business or whether such insurance will be available at premiums that are commercially reasonable. In addition, these insurance policies must be renewed annually. Although we have been able to obtain liability insurance, such insurance may not be available in the future on acceptable terms, if at all. A successful claim against us or settlement by us in excess of our insurance coverage or our inability to maintain insurance in the future could have a material adverse effect on our business, results of operations, liquidity and financial condition.

**If our systems fail to comply with domestic and international government regulations, or if these regulations result in a barrier to our business, we could lose sales.**

Our systems must comply with various domestic and international laws, regulations and standards. Additionally, new regulations enacted in various countries provide standards on waste management and recovery (the European Union Waste, Electrical and Electronic Equipment Directive) and the reduction of hazardous substances in electrical and electronic equipment (the European Union Restriction of Hazardous Substances Directive). In the event that we are unable or unwilling to comply with any such laws, regulations or standards, we may decide not to conduct business in certain markets. Particularly in international markets, we may experience difficulty in securing required licenses or permits on commercially reasonable terms, or at all. Failure to comply with existing or evolving laws or regulations, including export and import restrictions and barriers, or to obtain timely domestic or foreign regulatory approvals or certificates could result in lost sales.

**Fluctuations in our future operating results may negatively affect the market price of our common stock.**

We have experienced fluctuations in our quarterly operating results and we expect those fluctuations to continue due to a variety of factors. Some of the factors that influence our quarterly operating results include:

- § the number and mix of products sold in the quarter;
- § the timing of major projects;
- § the availability and cost of components and materials;
- § timing, costs and benefits of new product introductions;
- § customer order size and shipment timing;
- § seasonal factors affecting timing of purchase orders;
- § promotions by ourselves or competitors, and the timing of the promotion;
- § the impact to the marketplace of competitive products and pricing; and
- § the timing and level of operating expenses.

Because of these factors, our quarterly operating results are difficult to predict and are likely to vary in the future. If our operating results are below financial analysts' or investors' expectations, the market price of our common stock may fall abruptly and significantly.

**If we fail to retain and attract highly skilled managerial and technical personnel, we may fail to remain competitive.**

Our future success depends, in significant part, upon the continued service and performance of our senior management and other key personnel. The loss of the services of our management team, some of whom have significant experience in our industry and other key personnel, could impair our ability to effectively manage our company and to carry out our business plan. We do not carry key person life insurance on any of our executive officers. In addition, competition for skilled employees in our industry is intense. Our future success also depends on our continuing ability to attract, retain and motivate highly qualified managerial, technical and sales personnel. Our inability to retain or attract qualified personnel could have a significant negative effect and thereby materially harm our business and financial condition.

**Our stock price may be volatile and a shareholder's investment could decline in value.**

Our stock price has fluctuated in the past and may continue to fluctuate significantly, making it difficult for an investor to resell shares or to resell shares at an attractive price. The market prices for securities of emerging companies have historically been highly volatile. Future events concerning us or our competitors could cause such volatility, including:

- § actual or anticipated variations in our operating results,
- § investments required in infrastructure and/or personnel to meet long-term strategic objectives
- § technological innovations or new commercial products introduced by us or our competitors,
- § developments concerning proprietary rights,
- § changes in senior management,
- § investor perception of us and our industry,
- § general economic and market conditions including market uncertainty
- § national or global political events, and
- § public confidence in the securities markets and regulation by or of the securities markets.

In addition, the stock market is subject to price and volume fluctuations that affect the market prices for companies in general, and small-capitalization, high-technology companies in particular, which are often unrelated to the operating performance of these companies. Any failure by us to meet or exceed estimates of financial analysts is likely to cause a decline in our common stock price.

**Future sales of shares of our common stock in the public market may negatively affect our stock price.**

Future sales of our common stock, or the perception that these sales could occur, could have a significant negative effect on the market price of our common stock. In addition, upon exercise of outstanding options and warrants, the number of shares outstanding of our common stock could increase substantially. This increase, in turn, could dilute future earnings per share, if any, and could depress the market value of our common stock. Dilution and potential dilution, the availability of a large amount of shares for sale, and the possibility of additional issuances and sales of our common stock may negatively affect both the trading price of our common stock and the liquidity of our common stock. These sales also might make it more difficult for us to sell equity securities or equity-related securities in the future at a time and price that we would deem appropriate.

**Provisions of Minnesota law, our bylaws and other agreements may deter a change of control of our company and may have a possible negative effect on our stock price.**

Certain provisions of our Minnesota law, our bylaws and other agreements may make it more difficult for a third party to acquire, or discourage a third party from attempting to acquire, control of our company, including:

- § the provisions of Minnesota law relating to business combinations and control share acquisitions;
- § the provisions of our bylaws regarding the business properly brought before shareholders;
- § the right of our board of directors to establish more than one class or series of shares and to fix the relative rights and preferences of any such different classes or series;
- § our shareholder rights plan, which would cause substantial dilution to any person or group attempting to acquire our company on terms not approved in advance by our board of directors; and
- § the provisions of our stock option plans allowing for the acceleration of vesting or payments of awards granted under the plans in the event of specified events that result in a change in control.

These measures could discourage or prevent a takeover of our company or changes in our management, even if an acquisition or such changes would be beneficial to our shareholders. This may have a negative effect on the price of our common stock.

**Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.**

Keeping abreast of, and in compliance with, changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002 and in particular Section 404 of that act relating to management certification of internal controls, the regulations of the Securities and Exchange Commission and the rules of the Nasdaq Stock Market, have required an increased amount of management attention and external resources. We intend to invest all reasonably necessary resources to comply with evolving corporate governance and public disclosure standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Rimage headquarters are located in a leased facility of 58,500 square feet at 7725 Washington Avenue South, Edina, Minnesota 55439. The Company rents this facility under a noncancellable 48-month lease initiated August 1, 2004. Monthly base rent was \$33,394 for the first year, with 2% inflationary increases each subsequent year of the lease. This facility is used for manufacturing, engineering, service, sales, marketing and administration. Rimage also leases a facility of approximately 2,400 square feet in Dietzenbach, Germany used for service, sales and light assembly. The current term of the lease in Germany expires in December 2006. Additionally, the Company leases a facility of approximately 1,075 square feet in Tokyo, Japan, used for sales and service. The current term of the lease in Japan expires on March 31, 2007. Rimage believes its current facilities will accommodate operations through 2006, and continues to assess options to meet its future space requirements.

**ITEM 3. LEGAL PROCEEDINGS**

Rimage may become involved in various legal actions in the ordinary course of its business. Although the outcome of any such legal actions cannot be predicted, management believes that there are no pending legal proceedings against or involving Rimage for which the outcome is likely to have a material adverse effect upon its financial position or results of operations.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Rimage did not submit any matters to a vote of security holders during the last quarter of the fiscal year covered by this report.

**PART II****ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Rimage's common stock is traded on the Nasdaq Global Market under the symbol RIMG. The following table sets forth, for the periods indicated, the range of low and high prices for Rimage's common stock as reported on The Nasdaq Stock Market.

	<u>Low</u>	<u>High</u>
Calendar Year 2004:		
1st Quarter	13.56	17.50
2nd Quarter	13.11	17.40
3rd Quarter	12.02	15.21
4th Quarter	13.06	16.29
Calendar Year 2005:		
1st Quarter	15.43	21.40
2nd Quarter	18.59	22.50
3rd Quarter	20.11	27.03
4th Quarter	23.90	32.41

**Shareholders**

As of February 22, 2006, there were 75 shareholders of record of Rimage's common stock.

**Dividends**

To date, Rimage has not paid or declared any cash dividends on its common stock. The payment by Rimage of dividends, if any, on its common stock in the future is subject to the discretion of the Board of Directors and will depend on Rimage's continued earnings, financial condition, capital requirements and other relevant factors.

**ITEM 6. SELECTED FINANCIAL DATA**

The selected consolidated financial data below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below and the Consolidated Financial Statements and the Notes thereto included in Item 8 below. (In thousands, except per share data).

**Consolidated Statements of Income Information:**

	Year ended December 31				
	2005	2004	2003	2002	2001
Revenues	\$ 95,410	\$ 70,848	\$ 53,797	\$ 46,581	\$ 38,894
Cost of revenues	51,957	38,027	27,399	23,986	19,669
Gross profit	43,453	32,821	26,398	22,595	19,225
Operating expenses	26,829	19,386	14,841	13,176	12,760
Operating income	16,624	13,435	11,557	9,419	6,465
Other income, net	1,419	608	515	760	972
Income tax expense	6,675	4,971	4,406	3,715	2,628
Net income	11,368	9,072	7,666	6,464	4,809
Basic net income per share	\$ 1.19	\$ 0.98	\$ 0.86	\$ 0.74	\$ 0.55
Diluted net income per share	\$ 1.10	\$ 0.91	\$ 0.79	\$ 0.68	\$ 3.51
Weighted average shares outstanding:					
Basic	9,530	9,290	8,931	8,703	8,701
Diluted	10,312	9,932	9,743	9,497	9,509

**Consolidated Balance Sheet Information:**

	Balances as of December 31				
	2005	2004	2003	2002	2001
Cash and cash equivalents	\$ 18,489	\$ 13,320	\$ 26,742	\$ 17,339	\$ 14,767
Marketable securities	45,982				