RIMAGE CORP
Form 10-K
March 16, 2007
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FORM 10-K

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

x ANNUAL REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

OR

oTRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE

SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NO. 0-20728

RIMAGE CORPORATION

(Exact name of registrant as specified in its charter)

Minnesota	**41-1577970**
State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)
7725 Washington Avenue South, Minneapolis, Minnesota	**55439**
(Address of principal executive offices)	(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 checkmark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. **Yes** o **No** x

Indicate by checkmark 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
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 $200,500,000.

As of February 28, 2007, 9,954,597 shares of the registrant s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for its 2007 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 services. Blue laser capabilities were integrated into key products in late 2006 to address the needs of customers desiring the substantial increase in storage capacity provided by this emerging technology.

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.

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 of discs with unique content and labels.

The principal benefits to users of Rimage s products include unattended operation, reduced labor costs and higher throughput and quality than alternative systems. 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 for current, as well as past products.

Sales of CD-R/DVD-R production equipment comprised 54% of Rimage s revenue from operations during 2006 and 62% in both 2005 and 2004. 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.

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 hardware products continues to generate a significant portion of Rimage s revenue, comprising 44% of total revenues during 2006 at $44,874,000, and 51% in both 2005 and 2004, at $48,428,000 and $36,186,000, respectively. The Desktop line of hardware products contributed 10% of total revenues in 2006 at $10,640,000, and 11% of revenues in both 2005 and 2004, at

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$10,692,000 and $7,887,000, respectively. The balance of revenue in each year was generated through sale of Rimage-branded blank CD-R/DVD-R media, ribbons, ink cartridges, parts, repair services and maintenance contracts. Such recurring revenues comprised 46% of total revenue during 2006 at $47,738,000 and 38% 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 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 III Series. The Producer III Series of CD-R/DVD-R publishing systems, released in 2006, represents the latest generation of the high-performance 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. The Producer line of products also includes previously available systems from the Producer II Series and DiscLab Series. Each product in the Producer line incorporates recorders capable of recording on CD or DVD media, customized robotics, a thermal or thermal re-transfer printer for on-disc color printing, software and computer hardware components. Effective in late 2006, recorders that utilize blue laser technology are also available on Producer III equipment.

Rimage offers its Producer line of products in four basic configurations to meet the varying needs of its commercial customers. The Rimage 8100 system, part of the Producer III Series of publishing systems released in 2006, provides industry leading speed and throughput for on-demand CD-R/DVD-R production, utilizing up to four simultaneous data streams and four recorders, and provides for a capacity of 300 discs. The Rimage 7100 system, also part of the Producer III series, comes standard with two recorders. The Amigo II system, introduced in 2001, comes with a single recorder. The Rimage 8100 and Rimage 7100 systems are available with either a stand-alone control center or a control center embedded inside the unit. These two systems and the single-recorder Amigo II system are each 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 control center, an Everest printer and a small product size and footprint.

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 markets served by Rimage s Producer line of products include the digital photography, medical, banking, government and business services industries. Prices of the Producer line of publishing products range from $11,000 to $40,000.

The Desktop Series. 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. In June 2004, the Company introduced the two-drive recorder 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. Prices for the Desktop line of publishing products range from $2,500 to $4,000.

Marketing and Distribution

Rimage currently utilizes the following principal means of distributing its products: Direct sales using its own sales force; 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 while 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.

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During 2006, 2005 and 2004, Rimage derived 15%, 12% and 13% of its respective revenues from one of its distributors, and 9%, 11% and 12% of its respective revenues from a strategic partner. A second distributor grew to 14% of Rimage s revenues during 2006 from 8% in 2005.

Rimage conducts foreign sales through its U.S. operation and its subsidiaries in Germany and Japan, Rimage Europe GmbH and Rimage Japan Co., Ltd., respectively. Foreign sales constituted approximately 34% of Rimage s revenue for both years ended December 31, 2006 and 2005, and 38% of revenue in 2004.

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., Teac, 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, its software and its integration tools 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, the Internet and additional media under development. Rimage believes its technology has advantages over these alternative technologies in terms of usability, reliability, performance, privacy and cost.

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 DVD-R drives, circuit boards, electric motors, machined and molded parts, precision sheet metal assemblies, computer components and other mechanical parts. The Company depends upon a single-source supplier for its Everest printers.

Although Rimage believes it has identified alternative assembly contractors for most of its subassemblies and products, 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 increased costs, delivery delays, loss of sales and quality control issues as the Company seeks to secure alternative sources of supply.

Research and Development

At December 31, 2006, 32 full-time employees were involved in research and development at Rimage. This staff, with advanced development, 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 $6,738,000, $5,512,000 and $4,530,000 in 2006, 2005, and 2004, representing 6.5%, 5.8%, and 6.4% of revenues, respectively. Rimage anticipates its expenditures in research and development will approximate 7% to 8% of revenues during 2007.

Patents and Government Regulation

Rimage currently maintains nineteen U.S. and foreign patents and has a total of thirteen 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 assurance 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

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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 to enforce patents issued to it and to defend against claimed infringement of the rights of others or to determine the ownership, scope, or validity of Rimage s proprietary rights and the rights of others. Any claim of infringement against Rimage could involve significant liabilities to third parties, could require Rimage to seek licenses from third parties, and could prevent Rimage from manufacturing, selling or using its products.

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, 2006, Rimage had 205 full-time employees, of which 32 were involved in research and development, 97 in production, testing, repair and customer service, and 76 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, inte 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.

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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., Teac, R-Quest Technologies LLC, 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, DVD-R or blue laser 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 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% of our revenue for the years ended December 31, 2006 and 2005 and 38% of our revenue for the year ended December 31, 2004. 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;

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- 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 the 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 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. We may litigate to enforce patents issued to us and to defend 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 could 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.

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.

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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. Our distributors and resellers 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 2006, two of our distributors generated more than 10% of our revenues, at 15% and 14%. During 2005 and 2004, we derived 12% and 13% of our respective revenues from one of these distributors and approximately 11% and 12% of respective revenues from a strategic partner. 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 products. 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 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 Series and Desktop Series products using materials and components supplied by various subcontractors and suppliers. We purchase critical components for our systems, including 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.

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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 Series and Desktop Series of 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. 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.

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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, 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; and
- § the provisions of our agreements provide for severance payments to our executive officers in the event of certain terminations following a change in control.

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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. In July 2006 Rimage entered into a new facility lease of approximately 18,200 square feet in Dietzenbach, Germany used for service, sales and light assembly. The current term of the lease in Germany expires June 30, 2011, and monthly base rent is 14,833 (or approximately $19,000 U.S. dollars). Additionally, the Company leases a facility of approximately 1,109 square feet in Tokyo, Japan, used for sales and service. The current term of the lease in Japan expires on March 31, 2009. Rimage believes its current facilities will accommodate operations through 2007, 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.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

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.

	Low	**High**
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
Calendar Year 2006:		
1st Quarter	20.25	33.95
2nd Quarter	17.52	23.24
3rd Quarter	18.08	26.76
4th Quarter	20.50	27.04

Shareholders

As of February 19, 2007, there were 69 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.

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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				
	2006	**2005**	**2004**	**2003**	**2002**
Revenues	$103,252	$95,410	$70,848	$53,797	$46,581
Cost of revenues	56,014	51,957	38,027	27,399	23,986
Gross profit	47,238	43,453	32,821	26,398	22,595
Operating expenses	29,464	26,829	19,386	14,841	13,176
Operating income	17,774	16,624	13,435	11,557	9,419
Other income, net	2,684	1,419	608	515	760
Income tax expense	7,374	6,675	4,971	4,406	3,715
Net income	13,084	11,368	9,072	7,666	6,464
Basic net income per share	$1.33	$1.19	$0.98	$0.86	$0.74
Diluted net income per share	$1.26	$1.10	$0.91	$0.79	$0.68
Weighted average shares outstanding:					
Basic	9,812	9,530	9,290	8,931	8,703
Diluted	10,356	10,312	9,932	9,743	9,497

Consolidated Balance Sheet Information:

	Balances as of December 31				
	2006	2005	2004	2003	2002
Cash and cash equivalents	$8,500	$12,693	$12,120	$26,742	$17,339
Marketable securities	30,266	51,582	40,375	21,855	18,998
Receivables, net	21,697	12,885	10,184	6,243	6,644
Inventories	6,072	6,621	7,396	3,334	3,042
Current assets	70,116	86,444	71,665	59,849	47,337
Property and equipment, net	3,626	2,525	2,386	1,137	1,314
Marketable securities - non-current	38,594				
Total assets	112,359	89,009	74,138	61,024	48,709
Current liabilities	16,163	12,191	11,277	9,013	6,552
Long-term liabilities	720	289	139		
Stockholders equity	95,476	76,529	62,722	52,011	42,157

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The percentage relationships to revenues of certain income and expense items for the three years ended December 31, 2006 and the percentage changes in these income and expense items between years are contained in the following table:

	Percentage (%) of Revenues			Percent (%) Increase (Decrease) Between Periods	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
Revenues	100.0	100.0	100.0	8.2	34.7
Cost of revenues	(54.2)	(54.5)	(53.7)	7.8	36.6
Gross profit	45.8	45.5	46.3	8.7	32.4
Operating expenses:					
Research and development	(6.5)	(5.8)	(6.4)	22.2	21.7
Selling, general and administrative	(22.0)	(22.3)	(20.9)	6.6	43.5
Operating income	17.2	17.4	19.0	6.9	23.7
Other income, net	2.6	1.5	0.8	89.1	133.3
Income before income taxes	19.8	18.9	19.8	13.4	28.5
Income tax expense	(7.1)	(7.0)	(7.0)	10.5	34.3
Net income	12.7	11.9	12.8	15.1	25.3

Overview

Rimage develops, manufactures and distributes CD-Recordable (CD-R) and DVD-Recordable (DVD-R) publishing and duplication systems from its operations in the United States and Germany, and effective June 2005, in Japan. These systems allow customers to benefit from cost savings by eliminating their manual labor efforts in industries such as digital photography, medical imaging, banking and finance, government and business services. Rimage anticipates increased sales and marketing expenditures in 2007 as a result of increased resources focused on developing these markets. As Rimage s sales within North America and Europe have averaged 94% of total sales over the past three years, the strength of the economies in these regions plays an important role in determining the success of Rimage.

Rimage earns revenues through the sale of equipment, consumables (ribbons, ink cartridges and Rimage-branded blank CD-R and DVD-R media), maintenance contracts, parts and repair services. Rimage s recurring revenues (consumables, maintenance contracts, parts and service) comprised approximately 46% of its consolidated revenues in 2006 and 38% of revenues in both 2005 and 2004. Rimage has no long-term debt and does not require significant capital investment as all fabrication of its products is outsourced to vendors.

Results of Operations

Revenues. Revenues were $103.3 million, $95.4 million and $70.8 million for 2006, 2005 and 2004, respectively, reflecting increases of approximately 8%, 35% and 32%, respectively, over the prior years.

The growth in revenues from 2005 to 2006 was primarily driven by an increase of 31%, or $11.4 million, in the volume of recurring revenues, consisting of sales of blank CD-R and DVD-R media, media kits, printer ribbons, ink cartridges, parts and maintenance contracts. The strong growth in recurring revenues was primarily due to the continued expansion of the Company s worldwide installed base of CD-R and DVD-R publishing systems and the Company s increased emphasis on promoting this portion of its business. Partially offsetting the growth in recurring revenues was a decrease in the volume of sales of Producer product line equipment of $3.5 million, resulting primarily from reduced sales volume in the retail market. The reduction in 2006 retail sales was impacted by the Company s product rollout into the U.S. retail market in 2005, which generated equipment sales of approximately $9.0 million. Sales of desktop product line equipment were relatively flat from 2005 to 2006.

International sales rose 7% in 2006 and comprised 34% of total sales, compared to 34% in 2005 and 38% in 2004. The European market continued to generate the majority of international sales. Sales in Asian markets increased 35% in 2006, reflecting increased sales efforts in this region with the establishment of a subsidiary operation in Japan in 2005. Currency fluctuations affecting the Company s European and Japanese operations increased reported 2006 consolidated revenues by less than 1% relative to 2005.

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The growth in revenues from 2004 to 2005 was impacted by an increased volume of sales in all product line categories, with Producer product line equipment contributing the largest growth among all products at $12.2 million. Producer product line sales in 2005 included the shipment of approximately $9.0 million in equipment related to the Company s product rollout into the U.S. retail market. Recurring revenues also contributed significantly to sales growth, generating increased sales volume of $9.5 million in 2005. The strong growth in recurring revenues was primarily due to the continued expansion of the Company s worldwide installed base of CD-R and DVD-R publishing systems and increased emphasis on sales of consumables and maintenance contracts. Sales of desktop product line equipment increased $2.8 million from 2004 to 2005. Currency fluctuations primarily affecting the Company s European operations decreased reported 2005 consolidated revenues by less than 1% relative to 2004.

The Company expects to achieve continued revenue growth in 2007, the rate at which will be dependent upon many factors, including the effectiveness of the Company s channel partners, the timing of new product introductions, the rate of adoption of new applications for the Company s products in its targeted markets and the impact of foreign currency exchange rate fluctuations.

Gross Profit. Gross profit as a percentage of revenues was 45.8% for the year ended December 31, 2006, compared to 45.5% and 46.3% for the years ended December 31, 2005, and 2004, respectively.

Gross profit as a percentage of revenues increased slightly in 2006 relative to 2005 in spite of a lower volume and concentration of Producer product line equipment sales, which generally carry higher margins than desktop product line equipment or recurring revenues, and the inclusion in 2006 cost of sales of charges of $648,000. Producer product line equipment sales comprised 44% of total revenues in 2006, compared to 51% in 2005. The volume and concentration of recurring revenues, which generally carry lower margins than equipment sales, increased to 46% of total revenues, compared to 38% in 2005. Offsetting the unfavorable impact on gross margin of the described changes in product mix and charges to cost of sales was an improvement in service related margins, stemming from a higher rate of growth of service related revenues relative to associated support costs. Additionally, equipment revenues in 2006 were more concentrated in higher margin transactions, impacted by higher average selling prices for some Producer equipment configurations. The charges to cost of sales of $648,000 were generated by a reserve for excess raw material inventory ($336,000) and a write-down of fixed assets for an impairment in the carrying amount of manufacturing tooling ($312,000). Both charges were incurred in the fourth quarter and were driven by slow sales of the Rimage 360i desktop product line. Stock-based compensation expense included in cost of revenue for 2006 had a minimal impact on gross profit as a percentage of revenues, and amounted to $86,000.

The small decline in gross profit as a percentage of revenues from 2004 to 2005 was primarily due to increased costs for service and manufacturing labor and overhead stemming from increased investments in these areas to support an expected continued growth in total sales.

Future gross profit margins will continue to be affected by many factors, including product mix, the timing of new product introductions, changes in material costs, manufacturing volume, the rate of growth of service related revenues relative to associated service support costs and foreign currency exchange rate fluctuations.

Operating Expenses. Research and development expenses were $6.7 million, $5.5 million and $4.5 million for the years ended December 31, 2006, 2005 and 2004, respectively, representing 6.5%, 5.8% and 6.4% of revenues, respectively.

The 22% increase in research and development expenses from 2005 to 2006 reflect development costs to support the introduction in 2006 of the Company s next generation Producer product line, continued development of new products and enhancements to existing products. Stock-based compensation expenses increased research and development expenses by $163,000 in 2006.

Research and development expenses increased 22% from 2004 to 2005, reflecting continued development of next generation products, materials and resources required to complete development work on the Rimage 360i desktop product released in the second quarter of 2005 and a 21% increase in average headcount to support continued development of new products and enhancements to existing products.

Rimage anticipates increased expenditures in research and development in 2007 to support new product development initiatives and improve existing products.

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Selling, general and administrative expenses for the years ended December 31, 2006, 2005 and 2004 were $22.7 million, $21.3 million and $14.9 million, respectively, representing 22.0%, 22.3% and 20.9% of revenues, respectively.

The 7% growth in selling, general and administrative expenses in 2006 relative to 2005 reflects an increase in general and administrative expenses of $1.9 million and a reduction in sales and marketing expenses of $0.5 million. The increase in general and administrative expenses in 2006 was primarily the result of $1.4 million of expenses incurred during the year to support the implementation of a new enterprise resource planning system, increased costs associated with a 23% increase in headcount and stock-based compensation expenses of $1.2 million. Partially offsetting the described increases in general and administrative expenses was a $1.1 million reduction in consulting expenses associated with a strategic analysis of the Company s operations initiated in the last half of 2005 and completed during the first quarter of 2006. The decline in sales and marketing expenses is primarily the result of reduced costs for advertising and promotional activities due to implementation of programs in the prior year s second quarter to support the launch of the Rimage 360i desktop product, and a reduction in cooperative marketing program costs resulting from the Company s transition to an alternative program format with its distributors. These expense reductions were partially offset by stock-based compensation expenses of approximately $0.3 million.

The 44% increase in selling, general and administrative expenses from 2004 to 2005 reflects an increase in sales and marketing costs of $2.3 million and an increase in general and administrative expenses of $4.1 million. The growth in sales and marketing expenses is the result of the implementation of programs to support the second quarter launch of the Rimage 360i desktop product and other marketing initiatives and promotional activities, as well as a 14% increase in average sales and marketing headcount relative to the prior year. The increase in general and administrative expenses in 2005 was impacted largely by $2.3 million of consulting expenses incurred in the last half of the year for a strategic analysis of the Company s operations and potential new applications for its products. Also contributing to the expense growth in 2005 were increased costs associated with a 20% increase in average headcount and increased management compensation costs.

Selling, general and administrative expenses in 2007 are expected to increase relative to 2006 as a result of increased costs to support initiatives to further expand and strengthen the Company s global sales and marketing organization, expenses to conclude the implementation of the initial phases of a new enterprise resource planning system in the Company s U.S. and European operations and increased expenses for stock-based compensation.

Other Income, Net. The Company recognized interest income on cash and marketable securities of $2.8 million, $1.5 million and $0.7 million in 2006, 2005 and 2004, respectively. The year-over-year increases in interest income were driven by a $12.8 million and a $7.8 million respective increase in average cash equivalent and marketable securities balances and a small increase in average effective yields. See Liquidity and Capital Resources below for a discussion of changes in cash levels. Other income in each year was impacted by gains or losses on foreign currency transactions, with a net loss of approximately $0.1 million in both 2006 and 2005 and a net gain of $18,000 in 2004.

Income Taxes. The provision for income taxes represents federal, state, and foreign income taxes on income. For the years ended December 31, 2006, 2005 and 2004, income tax expense amounted to $7.4 million, $6.7 million and $5.0 million, respectively, representing 36.0%, 37.0% and 35.4% of income before income taxes, respectively. The decrease in the effective tax rate in 2006 from 2005 primarily reflects increased tax-exempt interest income and a net reduction of $0.1 million in the tax contingency reserve for the elimination of exposure items included in the prior years tax reserves. The increase in the effective tax rate in 2005 relative to 2004 primarily reflects the impact of higher taxable income, a portion of which was subject to a tax surcharge, an increase in state income taxes and a reduced benefit for the research tax credit. The Company anticipates its effective tax rate will range between 36% and 37% for the full year 2007.

Net Income / Net Income Per Share. Resulting net income for the years ended December 31, 2006, 2005 and 2004 amounted to $13.1 million, $11.4 million and $9.1 million, representing 12.7%, 11.9% and 12.8% of revenues, respectively. Related net income per diluted share amounts were $1.26 in 2006, $1.10 in 2005 and $0.91 in 2004.

Liquidity and Capital Resources

The Company expects it will be able to maintain current operations, including anticipated capital expenditure requirements, through its internally generated funds and, if required, from Rimage s existing credit agreement. The credit agreement allows for advances under an unsecured revolving loan up to a maximum advance of $10 million. At December 31, 2006, no amounts were outstanding under the credit agreement.

At December 31, 2006, the Company had working capital of approximately $54 million, a decrease of $20 million from working capital reported at December 31, 2005. The decline was primarily impacted by the purchase of $38.6 million of non-current marketable securities and capital expenditures of $2.7 million, partially offset by annual net income of $13.1 million and proceeds from employee stock plans of $2.3 million. The Company intends on utilizing its current assets primarily for its continued organic growth. Additionally, the Company may use its available cash for potential future strategic initiatives or alliances.

Net cash provided by operating activities totaled $12.0 million, $11.5 million and $5.1 million for the years ended December 31, 2006, 2005 and 2004, respectively. The $0.5 million increase in cash provided by operating activities in 2006 relative to 2005 was due to a $3.3 million increase in net income adjusted for non-cash items, partially offset by a $1.7 million larger use of cash from changes in operating assets and liabilities and the impact of a $1.2 million non-cash reduction in operating cash flows associated with excess tax benefits recognized as an addition to the additional paid-in-capital (APIC) pool under SFAS 123R. SFAS 123R requires such amounts to be reported as a reduction in operating activities and an addition to financing activities in the Statement of Cash Flows. Primarily contributing to the change in operating assets and liabilities was a $6.1 million larger increase in accounts receivable in 2006, partially offset by a $3.7 million larger net increase in the primary operating liability accounts; consisting of trade accounts payable, income taxes payable, accrued expenses and deferred income. The larger increase in accounts receivable in 2006 relative to 2005 was driven largely by a $6.3 million increase in sales in the fourth quarter of 2006 relative to the prior year s fourth quarter, and a small increase in day s sales outstanding. The larger net increase in operating liability accounts was primarily affected by the timing of payments for accounts payable and income taxes payable, and an increase in deferred income relating to sales of maintenance contracts on a growing base of installed CD-R and DVD-R publishing systems.

Net cash used in investing activities amounted to $19.8 million, $12.5 million and $20.9 million for the years ended December 31, 2006, 2005 and 2004, respectively. Cash used in investing activities for each year primarily reflects purchases of marketable securities, net of maturities of marketable securities. Investing activities also include purchases of property and equipment of $2.7 million in 2006, $1.3 million in 2005 and $2.2 million in 2004. Purchases in 2006 consisted primarily of costs capitalized as part of the implementation of an enterprise resource planning system and purchases of furniture and leasehold improvements for a new leased facility for the Company s operations in Germany. Costs capitalized in 2006 for the enterprise resource planning system amounted to $1.7 million, and consisted of system software, hardware and software development costs. In 2007, the Company expects total capital expenditures to range between $1.5 million and $2.5 million, primarily reflecting investments to support the Company s information technology requirements and the production and product development processes.

Net cash provided by financing activities totaled $3.4 million in 2006, $1.8 million in 2005 and $1.0 million in 2004. Financing activities in each year included proceeds from stock option exercises and purchases under the Company s Employee Stock Purchase Plan of $2.3 million, $1.8 million and $1.0 million, respectively. Additionally, 2006 financing activities include $1.2 million associated with excess tax benefits recognized as an addition to the APIC pool, which as discussed above, are required to be reported as an addition to financing activities in the Statements of Cash Flows under the provisions of SFAS 123R.

A summary of Rimage s contractual obligations for minimum lease payments under non-cancelable operating or capital leases and other non-cancelable obligations at December 31, 2006 is as follows (in thousands):

	Payments due by period					
Contractual Obligations	**Total**	**2007**	**2008**	**2009**	**2010**	**2011**
Operating leases	$ 2,631	1,006	804	450	255	116
Capital leases (1)	35	30	5			
Inventory purchase obligations (2)	3,719	3,719				
Total contractual cash obligations	$ 6,385	4,755	809	450	255	116

(1) Amounts include principal and interest.
(2) Represents non-cancelable purchase order commitments to a supplier of the Company for delivery of inventory during 2007.

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Critical Accounting Policies

Management utilizes its technical knowledge, cumulative business experience, judgment and other factors in the selection and application of the Company s accounting policies. The following accounting policies are considered by management to be the most critical to the presentation of the consolidated financial statements because they require the most difficult, subjective and complex judgments. Given the implementation effective January 1, 2006 of SFAS 123R, Share-Based Payment, the Company added a new critical accounting policy in 2006 for its accounting for stock-based compensation, discussed below. Additionally, the Company added a critical accounting policy in the fourth quarter of 2006 for its analysis of the impairment of long-lived assets, also discussed below.

In applying the critical accounting policies described below, management reassesses its estimates each reporting period based on available information. Changes in such estimates in 2006 primarily involved the Company s assessment of required inventory reserves and its analysis of potential asset impairment. The impact of these changes on earnings for the year ended December 31, 2006 is discussed below.

Revenue Recognition. Revenue for product sales (including hardware and consumables), which do not include any requirement for installation or training, is recognized on shipment, at which point the following criteria of SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, Topic 13(A)(1) have been satisfied:

Persuasive evidence of an arrangement exists. Orders are received for all sales and sales invoices are mailed on shipment.

Delivery has occurred. Product has been transferred to the customer or the customer s designated delivery agent, at which time title and risk of loss transfers.

The vendor s price is fixed or determinable. All sales prices are fixed at the time of the sale (shipment).

Collectibility is probable. All sales are made on the basis that collection is expected in line with the Company s standard payment terms, which are consistent with industry practice in the geographies in which the Company markets its products.

A standard product sale by the Company does not require a commitment on the Company s part to provide installation, set-up or training. When such services are requested, value-added resellers generally arrange and perform the service directly with the customer, with no financial interest or obligation on the part of the Company. In the limited situations in which the Company does provide installation or training services for customers, the Company charges separately for the service based upon its published list prices, and recognizes the associated service revenue upon the successful completion of the service.

The Company records a reserve for sales returns from its customers. The amount of the reserve is based upon historical trends, timing of new product introductions and other factors. A return policy is in place with the Company s distributors to restrict the volume of returned products, and the Company reviews the distributor s inventory to insure compliance with the return policy.

Revenue for maintenance agreements is recognized on a straight-line basis over the life of the contracts, in accordance with FASB Technical Bulletin No. 90-1, Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts.

Emerging Issues Task Force (EITF) Issue No. 00-21, Revenue Arrangements with Multiple Deliverables provides revenue recognition guidance for arrangements with multiple deliverables, and the criteria to determine if items in a multiple deliverable agreement should be accounted for separately. The elements of the Company s sales transactions are clearly and separately stated and sufficient evidence of their fair value exists to separately account for the elements.

Allowance For Doubtful Accounts And Sales Returns. The Company records a reserve for accounts receivable that are potentially uncollectible. The reserve is established based on a specific assessment of accounts with known collection exposure, based upon a review of the age of the receivable, the customer s payment history, the customer s financial condition and industry and general economic conditions, as well as a general assessment of collection exposure in the remaining receivable population based upon bad debt history. Actual bad debt exposure could differ significantly from management s estimates if economic conditions worsened for the Company s customers. As described above under Revenue Recognition, the Company also records a reserve for sales returns from its customers. The amount of the reserve is based upon historical trends, timing of new product introductions and other factors.

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Inventory Reserves. The Company records reserves for inventory shrinkage and for potential excess, obsolete and slow moving inventory. The amounts of these reserves are based upon usage, historical loss trends, inventory levels, expected product lives and forecasted sales demand. Results could be materially different if demand for the Company s products decreased because of economic or competitive conditions, or if products became obsolete because of technical advancements in the industry or by the Company.

In the fourth quarter of 2006, the Company recorded a reserve of $0.3 million for the estimated value of excess raw material inventory used to assemble the Rimage 360i desktop product line. The reserve was driven by slow sales of the 360i product line in the last half of 2006.

Deferred Tax Assets. The Company recognizes deferred tax assets for the expected future tax impact of temporary differences between book and taxable income. A valuation allowance and income tax charge are recorded when, in management s judgment, realization of a specific deferred tax asset is uncertain. Income tax expense could be materially different from actual results because of changes in management s expectations regarding future taxable income, the relationship between book and taxable income and tax planning strategies employed by the Company.

Warranty Reserves. The Company s non-consumable products are warranted to the end-user to ensure end-user confidence in design, workmanship and overall quality. Warranty lengths vary by product type, ranging from periods of six to twelve months. Warranty covers parts, labor and other associated expenses. The Company performs the majority of warranty work, while authorized distributors and dealers also perform some warranty work. The Company records a liability for estimated future warranty claims during the warranty period. The amount of the liability is based on an analysis of historical claims experience, which includes labor, parts and freight costs and consideration of the proportion of parts that can be re-used. Also considered are the anticipated impact of product improvements, releases of new products and other factors. Claims experience could be materially different from actual results because of the introduction of new, more complex products; a change in the Company s warranty policy in response to industry trends, competition or other external forces; or manufacturing changes that could impact product quality.

Stock-Based Compensation. The Company implemented the fair value recognition provisions of SFAS No. 123R effective January 1, 2006 using the modified prospective method. Under this method, the Company recognizes compensation expense on a straight-line basis over the vesting period for all stock-based awards granted on or after January 1, 2006, and for previously granted awards not yet vested as of January 1, 2006. The Company recognized stock-based compensation costs of approximately $1.7 million for the year ended December 31, 2006.

The Company utilizes a Black-Scholes option pricing model to estimate the fair value of each award on the date of grant. The Black-Scholes model requires the input of certain assumptions that involve management judgment. Key assumptions that affect the calculation of fair value include the expected life of stock-based awards and the Company s stock price volatility. Additionally, the Company is required to estimate the expected forfeiture rate of unvested awards and recognize expense for only those shares expected to vest. The assumptions used in calculating the fair value of stock-based awards and the forfeiture rate of such awards reflect management s best estimates. However, circumstances may change and additional data may become available over time, which could result in changes to these assumptions that materially impact the fair value determination of future awards or their estimated rate of forfeiture. If factors change and the Company uses different assumptions in the application of SFAS 123R in future periods, the compensation expense recorded under SFAS 123R may differ significantly from the expense recorded in the current period. See Note 2 under the Notes to Consolidated Financial Statements in this Form 10K for additional information on stock-based compensation.

Impairment of Long-lived Assets. Long-lived assets at December 31, 2006 consisted of property and equipment. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for Impairment or Disposal of Long-Lived Assets, the Company reviews the carrying amount of its long-lived assets when events or changes in circumstances such as market value, asset utilization, physical change, legal factors or other matters indicate that the carrying amount of the assets may not be recoverable. When this review indicates the carrying amount of an asset or asset group exceeds the sum of the future undiscounted cash flows expected to be generated by the assets, the Company recognizes an asset impairment charge against operations for the amount by which the carrying amount of the impaired asset exceeds its fair value. Considerable judgment is required in the evaluation of whether certain events or circumstances lead to an indication of impairment, and in the assumptions used in determining the amount and period over which future revenues are expected to be earned, related costs, terminal values and discount rates.

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In 2006, the Company recorded a charge to cost of revenues of approximately $0.3 million for an impairment in the carrying amount of manufacturing tooling associated with the assembly of the Rimage 360i desktop product line. The impairment charge was triggered by slow sales of the Rimage 360i product and a resulting reduction in the estimated cash flows attributable to future use of the manufacturing tooling.

New Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This Interpretation is effective for the Company beginning in fiscal year 2007. The Company currently does not expect that the adoption of this Interpretation will have a material impact on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements. SFAS No. 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair-value measurements. This Statement applies only to fair-value measurements that are already required or permitted by other accounting standards, except for measurements of share-based payments and measurements that are similar to, but not intended to be, fair value. This statement is expected to increase the consistency of fair value measurements, but imposes no requirements for additional fair-value measures in financial statements. The provisions under SFAS No. 157 are effective for the Company beginning January 1, 2008, and are expected to be applied prospectively. The Company is currently evaluating the impact of adopting this pronouncement on its consolidated financial statements and related disclosures.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB 108 requires registrants to quantify misstatements using both the balance sheet and income statement approaches and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. When the effect of initial adoption is determined to be material, SAB 108 allows registrants to record that effect as a one-time cumulative-effect adjustment to beginning-of-year retained earnings. The requirements under the SAB are effective for the Company for its 2006 annual financial statements. The adoption of SAB 108 did not have an impact on the Company s consolidated financial statements for the year ended December 31, 2006.

Available Information

Rimage maintains a website at www.rimage.com. Its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, are available on its website, as soon as reasonably practicable after these documents are filed with the SEC. To obtain copies of these reports, go to www.rimage.com and click on Investor Relations, then click on EDGAR Filings. A copy of any report filed by the Company with the SEC will also be furnished without charge to any shareholder who requests it in writing to: Secretary, Rimage Corporation 7725 Washington Avenue South, Minneapolis, Minnesota 55439.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Translation. The Company is exposed to market risk from foreign exchange rate fluctuations of the European Euro and Japanese Yen to the U.S. dollar as the financial position and operating results of the Company s German and Japanese subsidiaries, Rimage Europe GmbH and Rimage Japan Co., Ltd., respectively, are translated into U.S. dollars for consolidation. Resulting translation adjustments are recorded as a separate component of stockholders equity.

Derivative financial instruments. The Company enters into forward exchange contracts principally to hedge inter-company receivables denominated in Euros arising from sales to its subsidiary in Germany. Gains or losses on forward exchange contracts are calculated at each period end and are recognized in net income in the period in which they arose. The Company records the fair value of its open forward foreign exchange contracts in other current assets or other

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current liabilities depending on whether the net amount is a gain or a loss. The Company does not utilize financial instruments for trading or other speculative purposes.

Exchange Rate Sensitivity. The table below summarizes information on foreign currency forward exchange agreements that are sensitive to foreign currency exchange rates. For these foreign currency forward exchange agreements, the table presents the notional amounts and weighted average exchange rates by expected (contractual) maturity dates. These notional amounts generally are used to calculate the contractual payments to be exchanged under the contract.

	Expected Maturity or Transaction Date						
	2007	**2008**	**2009**	**2010**	**There-after**	**Total**	**Fair Value**
Anticipated Transactions and Related Derivatives	(US$ Equivalent in Thousands)						
Forward Exchange Agreements (Receive $US/Pay)							
Contract Amount	$5,617					$5,617	($164)
Average Contractual Exchange Rate	1.2887					1.2887	

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Financial Statements

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Management s Report on Internal Control over Financial Reporting

The Board of Directors and Stockholders

Rimage Corporation:

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a15-(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision of our chief executive officer and our chief financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment and those criteria, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2006.

KPMG LLP, the independent registered public accounting firm that audited our consolidated financial statements in this Form 10-K, has issued an attestation report on management s assessment of the effectiveness of the Company s internal control over financial reporting, which report is included in this Form 10-K.

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Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements

The Board of Directors and Stockholders

Rimage Corporation:

We have audited the accompanying consolidated balance sheets of Rimage Corporation and subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Rimage Corporation and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment,* on January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Rimage Corporation s internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 15, 2007 expressed an unqualified opinion on management s assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Minneapolis, Minnesota

March 15, 2007

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Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

The Board of Directors and Stockholders

Rimage Corporation:

We have audited management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, that Rimage Corporation (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Rimage Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Rimage Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Rimage Corporation and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated March 15, 2007 expressed an unqualified opinion on those financial statements. Our report stated the Company adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* on January 1, 2006.

/s/ KPMG LLP

Minneapolis, Minnesota

March 15, 2007

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RIMAGE CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2006 and 2005

(In thousands, except share data)

Assets	December 31, 2006	December 31, 2005
Current assets:		
Cash and cash equivalents	$ 8,500	$ 12,693
Marketable securities	30,266	51,582
Receivables, net of allowance for doubtful accounts and sales returns of $878,000 and $854,000, respectively	21,697	12,885
Inventories	6,072	6,621
Prepaid expenses and other current assets	1,151	1,284
Deferred income taxes - current	2,430	1,379
Total current assets	70,116	86,444
Marketable securities - non-current	38,594	
Property and equipment, net	3,626	2,525
Deferred income taxes - non-current	23	18
Other non-current assets		22
Total assets	$ 112,359	$ 89,009
Liabilities and Stockholders Equity		
Current liabilities:		
Trade accounts payable	$ 7,136	$ 5,413
Accrued compensation	2,882	2,896
Other accrued expenses	1,237	1,332
Income taxes payable	1,207	283
Deferred income and customer deposits	3,509	2,255
Other current liabilities	192	12
Total current liabilities	16,163	12,191
Long-term liabilities:		
Deferred income	715	276
Other non-current liabilities	5	13
Total long-term liabilities	720	289
Total liabilities	16,883	12,480
Commitments and contingencies (notes 10 and 14)		
Stockholders equity:		
Preferred stock, $.01 par value, authorized 250,000 shares, no shares issued and outstanding		
Common stock, $.01 par value, authorized 29,750,000 shares, issued and outstanding 9,925,430 and 9,630,324 respectively	99	96
Additional paid-in capital	27,914	22,389
Retained earnings	67,324	54,240
Accumulated other comprehensive income (loss)	139	(196)
Total stockholders equity	95,476	76,529
Total liabilities and stockholders equity	$ 112,359	$ 89,009

See accompanying notes to consolidated financial statements

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RIMAGE CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income

Years Ended December 31, 2006, 2005 and 2004

(In thousands, except per share data)

	2006	2005	2004
Revenues	$103,252	$95,410	$70,848
Cost of revenues	56,014	51,957	38,027
Gross profit	47,238	43,453	32,821
Operating expenses:			
Research and development	6,738	5,512	4,530
Selling, general and administrative	22,726	21,317	14,856
Total operating expenses	29,464	26,829	19,386
Operating income	17,774	16,624	13,435
Other income (expense):			
Interest, net	2,770	1,544	657
Gain (loss) on currency exchange	(86)	(134)	18
Other, net		9	(67)
Total other income, net	2,684	1,419	608
Income before income taxes	20,458	18,043	14,043
Income tax expense	7,374	6,675	4,971
Net income	$13,084	$11,368	$9,072
Net income per basic share	$1.33	$1.19	$0.98
Net income per diluted share	$1.26	$1.10	$0.91
Basic weighted average shares outstanding	9,812	9,530	9,290
Diluted weighted average shares outstanding	10,356	10,312	9,932

See accompanying notes to consolidated financial statements

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RIMAGE CORPORATION AND SUBSIDIARIES

Consolidated Statements of Stockholders Equity and Comprehensive Income

Years Ended December 31, 2006, 2005, and 2004

(In thousands)

	Common Stock				Accumulated other comprehensive income (loss)	
	Shares	**Amount**	**Additional paid-in capital**	**Retained earnings**		**Total**
Balance at December 31, 2003	9,110	$91	$18,157	$33,800	$ (36)	$52,012
Stock issued for employee stock plans	255	3	991			994
Income tax reductions relating to exercise of stock options			522			522
Accelerated vesting of stock options			8			8
Comprehensive income:						
Net income				9,072		9,072
Translation adjustment					170	170
Unrealized loss from available- for-sale securities					(56)	(56)
Total comprehensive income						9,186
Balance at December 31, 2004	9,365	$94	$19,678	$42,872	$ 78	$62,722
Stock issued for employee stock plans	265	2	1,843			1,845
Income tax reductions relating to exercise of stock options			868			868
Comprehensive income:						
Net income				11,368		11,368
Translation adjustment					(314)	(314)
Unrealized gain from available- for-sale securities					40	40
Total comprehensive income						11,094
Balance at December 31, 2005	9,630	$96	$22,389	$54,240	($196)	$76,529
Stock issued for employee stock plans	295	3	2,260			2,263
Income tax reductions relating to exercise of stock options			1,583			1,583
Stock-based compensation			1,682			1,682
Comprehensive income:						
Net income				13,084		13,084
Translation adjustment					305	305
Unrealized gain from available- for-sale securities					30	30
Total comprehensive income						13,419
Balance at December 31, 2006	9,925	$99	$27,914	$67,324	$ 139	$95,476

See accompanying notes to consolidated financial statements.

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RIMAGE CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2006, 2005, and 2004

(in thousands)

	2006		2005		2004	
Cash flows from operating activities:						
Net income	$ 13,084		$ 11,368		$ 9,072	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	1,519		1,228		919	
Deferred income tax expense (benefit)	(1,056	)	(392	)	234	
Impairment of long-lived assets	312					
Loss on sale of property and equipment	41		33		106	
Stock-based compensation	1,681				8	
Excess tax benefits from stock-based compensation	(1,202	)				
Changes in operating assets and liabilities:						
Receivables	(8,812	)	(2,702	)	(3,941	)
Inventories	549		775		(4,061	)
Prepaid expenses and other current assets	133		(822	)	11	
Trade accounts payable	1,577		696		2,352	
Income taxes payable	2,507		51		(147	)
Accrued compensation	(14	)	596		641	
Other accrued expenses and other current liabilities	3		1		(95	)
Deferred income and customer deposits	1,693					