RIMAGE CORP
Form 10-Q
November 09, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED **September 30, 2006**; OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________TO __________.

Commission File Number: 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, Edina, MN 55439
(Address of principal executive offices)

952-944-8144
(Registrant s telephone number, including area code)

NA
(Former name, former address, and former fiscal year, if changed since last report.)

Common Stock outstanding at October 31, 2006 9,880,596 shares of $.01 par value Common Stock.

Indicate by check mark 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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

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

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FOR THE QUARTER ENDED SEPTEMBER 30, 2006

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RIMAGE CORPORATION AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
September 30, 2006 and December 31, 2005
(unaudited - in thousands, except share data)

Assets	September 30, 2006	December 31, 2005
Current assets:		
Cash and cash equivalents	$ 29,538	$ 18,489
Marketable securities	18,600	45,982
Trade accounts receivable, net of allowance for doubtful accounts and sales returns of $609,000 and $854,000, respectively	14,892	12,689
Inventories	6,496	6,621
Prepaid expenses and other current assets	1,103	1,284
Deferred income taxes - current	1,359	1,379
Total current assets	71,988	86,444
Property and equipment, net	3,924	2,525
Marketable securities - non-current	25,135	
Deferred income taxes - non-current	120	18
Other non-current assets		22
Total assets	$ 101,167	$ 89,009

Liabilities and Stockholders Equity		
Current liabilities:		
Trade accounts payable	$ 3,901	$ 5,413
Accrued compensation	1,973	2,896
Other accrued expenses	1,054	1,332
Income taxes payable	291	283
Deferred income and customer deposits	3,405	2,531
Other current liabilities	27	12
Total current liabilities	10,651	12,467
Long-term liabilities:		
Other non-current liabilities	12	13
Total long-term liabilities	12	13
Total liabilities	10,663	12,480
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 9,880,596 and 9,630,324, respectively	99	96
Additional paid-in capital	26,643	22,389
Retained earnings	63,699	54,240
Accumulated other comprehensive income (loss)	63	(196)

Total stockholders equity	90,504	76,529
Total liabilities and stockholders equity	$ 101,167	$ 89,009

See accompanying notes to condensed consolidated financial statements

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RIMAGE CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Income
(unaudited - in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Revenues	$ 24,777	$ 27,962	$ 72,733	$ 71,144
Cost of revenues	12,517	14,571	39,158	38,498
Gross profit	12,260	13,391	33,575	32,646
Operating expenses:				
Research and development	1,459	1,399	4,781	4,177
Selling, general and administrative	5,032	5,937	16,115	15,084
Total operating expenses	6,491	7,336	20,896	19,261
Operating income	5,769	6,055	12,679	13,385
Other income (expense):				
Interest, net	711	400	1,997	1,007
Gain (loss) on currency exchange	27	(40)		(113)
Other, net	1			1
Total other income, net	739	360	1,997	895
Income before income taxes	6,508	6,415	14,676	14,280
Income tax expense	2,067	2,330	5,217	5,216
Net income	$ 4,441	$ 4,085	$ 9,459	$ 9,064
Net income per basic share	$ 0.45	$ 0.43	$ 0.97	$ 0.95
Net income per diluted share	$ 0.43	$ 0.39	$ 0.92	$ 0.88

Basic weighted average shares outstanding	9,854	9,553	9,783	9,507
Diluted weighted average shares outstanding	10,375	10,380	10,336	10,250

See accompanying notes to condensed consolidated financial statements

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RIMAGE CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(unaudited - in thousands)

	Nine months ended September 30, 2006	2005
Cash flows from operating activities:		
Net income	$ 9,459	$ 9,064
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,076	867
Deferred income tax benefit	(82)	(110)
Loss on sale of property and equipment	28	38
Stock-based compensation	1,196	
Excess tax benefits from stock-based compensation	(1,003)	
Changes in operating assets and liabilities:		
Trade accounts receivable	(2,203)	(4,618)
Inventories	125	1,242
Prepaid income taxes / income taxes payable	1,289	862
Prepaid expenses and other current assets	182	(535)
Trade accounts payable	(1,512)	1,595
Accrued compensation	(923)	184
Other accrued expenses and other current liabilities	(279)	66
Deferred income and customer deposits	874	529
Net cash provided by operating activities	8,227	9,184
Cash flows from investing activities:		
Purchases of marketable securities	(106,118)	(84,350)
Maturities of marketable securities	108,440	91,676
Purchases of property and equipment	(2,454)	(1,133)
Proceeds from sale of property and equipment	4	5
Other non-current items	92	(119)
Net cash provided by (used in) investing activities	(36)	6,079
Cash flows from financing activities:		
Principal payments on capital lease obligations	(15)	(8)
Excess tax benefits from stock-based compensation	1,003	
Proceeds from employee stock plans	1,779	1,330

Net cash provided by financing activities	2,767	1,322
Effect of exchange rate changes on cash	91	(154)
Net increase in cash and cash equivalents	11,049	16,431
Cash and cash equivalents, beginning of period	18,489	13,321
Cash and cash equivalents, end of period	$ 29,538	$ 29,752
Supplemental disclosures of net cash paid during the period for:		
Income taxes	$ 4,011	$ 4,464
Non-cash investing and financing activities:		
Income tax reductions relating to exercise of stock options	$ 279	$ 467
Unrealized net gains from available-for-sale securities	$ 75	$ 50
Capital lease obligations	$ 30	$ 12

See accompanying notes to condensed consolidated financial statements

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RIMAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

(1) Basis of Presentation and Nature of Business

Rimage Corporation (the Company) develops, manufactures and distributes high performance CD-Recordable (CD-R) and DVD-Recordable (DVD-R) publishing and duplication systems from its operations in the United States, Germany and Japan. The Company also distributes related consumables for use with its systems, consisting of media kits, ribbons, ink cartridges and blank CD-R and DVD-R media.

The accompanying condensed consolidated financial statements of Rimage Corporation are unaudited and have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial information, pursuant to the rules and regulations of the Securities and Exchange Commission. Pursuant to such rules and regulations, certain financial information and footnote disclosures normally included in the financial statements have been condensed or omitted. However, in the opinion of management, the financial statements include all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the financial position and results of operations and cash flows of the interim periods presented. Operating results for these interim periods are not necessarily indicative of results to be expected for the entire year, due to seasonal, operating and other factors. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

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

(2) Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 123R, Share-Based Payment. SFAS 123R is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS 95, Statement of Cash Flows, and its related implementation guidance. SFAS 123R focuses primarily on accounting for transactions in which an entity obtains employee services through share-based payment transactions. SFAS 123R requires a public entity to measure the cost of employee services received in exchange for the award of equity instruments based on the fair value of the award at the date of grant. The cost is to be recognized over the period during which an employee is required to provide services in exchange for the award. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under the prior accounting rules. This requirement reduces net operating cash flows and increases net financing cash flows in periods after adoption. Total cash flow remains unchanged from what would have been reported under prior accounting rules.

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The Company implemented the provisions of SFAS 123R effective January 1, 2006 using the modified prospective method, and therefore has not restated prior periods results. Under this method, the Company recognizes compensation expense 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. Under the provisions of SFAS 123R, the Company recognizes stock-based compensation net of an estimated forfeiture rate, resulting in the recognition of compensation cost for only those shares expected to vest. Prior to the adoption of SFAS 123R, the Company followed the intrinsic value method in accordance with APB 25 to account for the issuance of stock incentives to employees and directors. Accordingly, no compensation expense was recognized for share purchase rights granted in connection with the Company s Amended and Restated 1992 Stock Option Plan (the Stock Option Plan) or the Company s Employee Stock Purchase Plan (the Employee Stock Purchase Plan).

The Stock Option Plan, initially approved by shareholders in September 1992, and with the latest amendments approved by shareholders in May 2005, provides for the grant of incentive stock options, non-qualified stock options, restricted stock awards, deferred stock awards, stock appreciation rights and performance stock to certain key administrative, managerial and executive employees and the automatic periodic grants of stock options to non-employee directors. At September 30, 2006, a total of 211,621 shares were available for future grant under the plan. The exercise price of stock options granted under the Stock Option Plan is equal to the market value on the date of grant. Options issued to employees through March 31, 2006 generally become exercisable over a two-year period and terminate ten years from the date of grant. Options issued to employees after March 31, 2006 generally become exercisable over a four-year period and terminate ten years from the date of grant. Stock options granted to non-employee directors vest six months from the date of grant and terminate ten years from the date of grant. Performance shares granted to employees under the Stock Option Plan are issued contingent on the Company s achievement of revenue and operating income performance goals for the calendar year which follows two years after the grant date. Shares of the Company s common stock are issued to employees for the performance shares only if the Company achieves the performance goals during the applicable performance period. If the performance goals are not achieved at the end of the performance period, all performance shares will be canceled and the employees will receive no common stock for the canceled performance shares.

The Employee Stock Purchase Plan was approved by shareholders in May 2001. Under this plan, employees were entitled to purchase the Company s common stock at 85% of the lower of the market price of such shares on the first or last business day of each one-year period. The Employee Stock Purchase Plan was terminated effective July 1, 2006, and no additional shares will be issued under that plan. Shares originally authorized and reserved for issuance under the Employee Stock Purchase Plan and remaining unissued after its termination amounted to 165,126 shares. Such shares are no longer reserved for issuance under the Employee Stock Purchase Plan.

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Amounts recognized in the financial statements with respect to the Company s share-based payment arrangements are as follows:

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
	(in thousands)	
Total stock-based compensation cost	$ 637	$ 1,197
Amounts capitalized in inventory	(1)	(1)
Amounts recognized in income for amounts previously capitalized in inventory	1	
Amounts charged against income, before income tax benefit	637	1,196
Income tax benefit related to stock-based compensation included in net income	(212)	(328)
Net compensation expense included in net income	$ 425	$ 868
Impact on net income per share:		
Basic	$ 0.04	$ 0.09
Diluted	$ 0.04	$ 0.08

Total stock-based compensation cost of $1,197,000 for the nine months ended September 30, 2006 reflected in the preceding table consists of $1,170,000 and $5,000 of expense associated with stock options and performance shares, respectively, both issued under the Stock Option Plan (including $322,000 related to options granted prior to January 1, 2006), and $22,000 of expense associated with the Employee Stock Purchase Plan.

The fair value of each option award is estimated at the date of grant using the Black-Scholes option pricing model. No option awards were granted during the three months ended September 30, 2006. The following key assumptions were utilized in valuing option awards issued during the nine months ended September 30, 2006:

	Nine Months Ended September 30, 2006
Expected life of options in years	5.0 - 6.0
Risk-free interest rate	4.3 - 5.0%
Volatility	37.8 - 50.4%
Expected dividend yield	0.0%

In accordance with SFAS 123R, the Company reviews these assumptions at the time of each new option award and adjusts them as necessary to ensure proper option valuation. The expected life of each award was determined based on an analysis of historical exercise behavior. The risk-free

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interest rate is based on the yield of constant maturity U.S. treasury bonds with a remaining term equal to the expected life of the awards. The Company estimated the stock price volatility using historical weekly price observations over the expected life of the awards. The expected dividend yield is zero, as the Company has not paid or declared any cash dividends on its common stock, and does not currently have plans to pay dividends.

A summary of share option activity under the Stock Option Plan as of and for the nine months ended September 30, 2006 is presented in the table below (in thousands, except per share data):

	Shares	WAEP*	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value**
Options outstanding at December 31, 2005	1,340	$ 10.67		
Granted	265	22.02		
Exercised	(231)	6.27		
Canceled	(5)	24.46		
Options outstanding at September 30, 2006	1,369	$ 13.56	6.30	$ 12,246
Options subject to exercise at September 30, 2006	1,025	$ 11.02	5.28	$ 11,737

**Weighted Average Exercise Price*

***Aggregate intrinsic value includes only those options with intrinsic value (options where the exercise price is below the market value).*

A summary of the status of the Company s nonvested option shares as of September 30, 2006 and changes during the nine months ended September 30, 2006 is presented in the table below (in thousands, except per share data):

	Number of Shares	Weighted Average Grant-Date Fair Value
Nonvested at December 31, 2005	206	$ 5.88
Granted	265	11.82
Vested	(121)	5.68
Cancelled	(4)	10.76
Nonvested at September 30, 2006	346	$ 10.44

As of September 30, 2006, there was $2,369,000 of total stock option compensation expense not yet recognized related to non-vested option awards, which is expected to be recognized over a weighted average period of 1.27 years.

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Other information pertaining to options is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
	(in thousands, except per share data)			
Number of options granted		18	265	314
Fair value of options granted	$	$ 224	$ 3,132	$ 1,978
Per share weighted average fair value of options granted	$	$ 12.44	$ 11.82	$ 6.31
Total fair value of stock options vested	$ 105	$ 162	$ 679	$ 891
Total intrinsic value of stock options exercised	$ 775	$ 817	$ 3,963	$ 2,734

Cash received from the exercise of stock options was $1,450,000 and $997,000 for the nine months ended September 30, 2006 and 2005, respectively. The income tax benefit realized from the exercise of stock options was $1,283,000 and $467,000 for the nine months ended September 30, 2006 and 2005, respectively.

Performance Shares:

During the three months ended September 30, 2006, the Company granted 16,967 performance shares to certain managerial and executive employees under the Stock Option Plan. The issuance of shares of the Company s common stock for the performance shares is contingent on the Company s achievement of revenue and operating income performance goals established for fiscal year 2008. If the performance goals are not achieved during the performance period, all performance shares will be canceled and the employees will receive no common stock for the canceled performance shares. An employee must also remain employed by the Company as of the end of the performance period to be eligible to receive common stock for the performance shares. During the period, 283 performance shares were canceled, leaving 16,684 outstanding performance shares as of September 30, 2006.

The valuation of the performance shares was based on the closing market price of the Company s common stock on the date of grant of $21.152, resulting in a total valuation of $359,000. Stock-based compensation expense charged against pre-tax income totaled $5,000 for the three and nine months ended September 30, 2006. Total stock-based compensation expense not yet recognized related to performance shares as of September 30, 2006 totaled $308,000, which is expected to be recognized over a weighted average period of 2.21 years, assuming the Company s achievement of the established performance goals for fiscal year 2008.

Results of operations for periods prior to 2006 have not been restated to reflect recognition of stock-based compensation expense. Had compensation costs for the Company s stock-based compensation been determined based on the fair value of the awards on the date of grant, consistent with the provisions of SFAS No. 123, the Company s net income and basic and diluted earnings per share for

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the three and nine months ended September 30, 2005 would have been adjusted to the proforma amounts stated in the following table (in thousands, except for per share data):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income:		
As reported	$ 4,085	$ 9,064
Stock-based employee compensation, net of tax	(416)	(977)

Proforma	$	3,669	$	8,087
Basic net income per share:				
As reported	$	0.43	$	0.95
Stock-based employee compensation, net of tax		(0.05)		(0.10)
Proforma	$	0.38	$	0.85
Diluted net income per share:				
As reported	$	0.39	$	0.88
Stock-based employee compensation, net of tax		(0.03)		(0.08)
Proforma	$	0.36	$	0.80

(3) Marketable Securities

Marketable securities consist primarily of municipal securities, U.S. government agency securities and commercial paper with long-term credit ratings of AAA and short-term credit ratings of A-1. Marketable securities are classified as short-term or long-term in the balance sheet based on their effective maturity date. All marketable securities have maturities ranging from three to 36 months and are classified as available-for-sale. Available-for-sale securities are recorded at fair value and any unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and are reported as a separate component of accumulated other comprehensive income (loss) until realized.

(4) Inventories

Inventories consisted of the following (in thousands):

	September 30, 2006		December 31, 2005	
Finished goods and demonstration equipment	$	1,281	$	1,562
Work-in-process				290
Purchased parts and subassemblies		5,215		4,769
	$	6,496	$	6,621

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RIMAGE CORPORATION AND SUBSIDIARIES
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(5) Comprehensive Income

Comprehensive income consists of the Company s net income, foreign currency translation adjustments and unrealized holding gains (losses) from available for sale investments. The components of and changes in other comprehensive income (loss) are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income	$ 4,441	$ 4,085	$ 9,459	$ 9,064
Other comprehensive income (loss):				
Net changes in:				
Foreign currency translation adjustments	37	(12)	184	(273)
Net unrealized gains on marketable securities	100	37	75	50
Total other comprehensive income	$ 4,578	$ 4,110	$ 9,718	$ 8,841

(6) Foreign Currency Contracts

The Company enters into forward foreign exchange contracts to hedge intercompany receivables denominated in Euros arising from sales to its subsidiary in Germany. Gains or losses on forward foreign exchange contracts are calculated at each period end and are recognized in net income in the period in which they arose. The fair value of forward foreign exchange contracts is recorded in other current assets or other current liabilities depending on whether the net amount is a gain or a loss.

As of September 30, 2006, the Company had seventeen outstanding foreign currency contracts totaling $3,573,000. These contracts mature in 2006 and early 2007 and bear rates ranging from 1.2516 to 1.29 U.S. Dollars per Euro. As of September 30, 2006, the fair value of foreign currency contracts is a net gain position of $21,000, recorded in other current assets.

As of December 31, 2005, the Company had twenty three outstanding foreign currency contracts totaling $4,578,000, all maturing during 2006 at rates ranging from 1.1724 to 1.2155 U.S. Dollars per Euro. As of December 31, 2005, the fair value of foreign currency contracts was a net gain position of $25,000, recorded in other current assets.

(7) Recently Issued Accounting Standards

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

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RIMAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

transition. This Interpretation is effective for the Company beginning in fiscal year 2007. The Company is currently evaluating the impact of adopting this pronouncement on its consolidated financial statements and related disclosures.

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 Company is currently evaluating the impact of adopting SAB 108 on its consolidated financial statements.

(8) Warranty Reserve

The warranty reserve rollforward, including provisions and claims, is as follows:

Nine Months Ended:	Beginning Balance	Warranty Provisions	Warranty Claims	Foreign Exchange Impact	Ending Balance
September 30, 2006	$ 317	551	(525)	8	$ 351
September 30, 2005	$ 187	699	(583)	(6)	$ 297

(9) Computation of Net Income Per Share of Common Stock

Basic net income per common share is determined by dividing net income by the weighted average number of shares of common stock outstanding. Diluted net income per common share includes the potentially dilutive effect of common shares issued in connection with outstanding stock options using the treasury stock method. Options to acquire 290,000 and 157,000 weighted average common shares have been excluded from the computation of diluted weighted average shares outstanding for the three

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and nine months ended September 30, 2006, respectively, as their effect is anti-dilutive. Similarly, options to acquire less than 1,000 and 4,000 weighted average common shares were excluded from the computation of diluted weighted average shares outstanding for the three and nine months ended September 30, 2005, respectively, as their effect was anti-dilutive. The following is a summary of the weighted average common shares outstanding and diluted potential common shares (in thousands, except for per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Shares outstanding at end of period	9,881	9,580	9,881	9,580

Weighted average shares outstanding	9,854	9,553	9,783	9,507
Weighted average potential common shares	521	827	553	743
Total diluted weighted average shares outstanding	10,375	10,380	10,336	10,250
Net income	$ 4,441	$ 4,085	$ 9,459	$ 9,064
Basic net income per common share	$ 0.45	$ 0.43	$ 0.97	$ 0.95
Diluted net income per common share	$ 0.43	$ 0.39	$ 0.92	$ 0.88

(10) Contingencies

The Company is exposed to a number of asserted and unasserted claims encountered in the normal course of business. In the opinion of management, the resolution of these matters will not have a material adverse effect on the Company s financial position or results of operations.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following table sets forth, for the periods indicated, selected items from the Company s consolidated statements of income.

	Percentage (%) of Revenues Three Months Ended September 30,		Percentage (%) Increase/(Decrease) Between Periods	Percentage (%) of Revenues Nine Months Ended September 30,		Percentage (%) Increase/(Decrease) Between Periods
	2006	**2005**	**2006 vs. 2005**	**2006**	**2005**	**2006 vs. 2005**
Revenues	**100**	100	(11)	**100**	100	2
Cost of revenues	**(51)**	(52)	(14)	**(54)**	(54)	2
Gross profit	**49**	48	(8)	**46**	46	3
Operating expenses:						
Research and development	**(6)**	(5)	4	**(7)**	(6)	14
Selling, general and admin	**(20)**	(21)	(15)	**(22)**	(21)	7
Operating income	**23**	22	(5)	**17**	19	(5)
Other income, net	**3**	1	105	**3**	1	123
Income before income taxes	**26**	23	1	**20**	20	3
Income tax expense	**(8)**	(8)	(11)	**(7)**	(7)	

Net income	**18**	15	9	**13**	13	4

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, Germany and Japan. These systems allow customers to benefit from cost savings by reducing their manual labor efforts in industries such as photography, medical, banking and government. Rimage anticipates increased future sales and marketing expenditures 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 each of these regions plays an important role in determining the success of Rimage.

Rimage earns revenues through the sale of equipment, consumables (ribbons, ink cartridges, media kits 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% and 37% of consolidated revenues during the nine months ended September 30, 2006 and 2005, respectively. Exclusive of a small amount of capital lease obligations, Rimage has no long-term debt and does not require significant capital investments as all fabrication of its products is outsourced to vendors.

Stock-Based Compensation

The Company implemented the provisions of Statement of Financial Accounting Standard (SFAS) No. 123R, Share-Based Payment effective January 1, 2006, using the modified prospective method, and therefore has not restated prior periods results. Prior to the adoption of SFAS 123R, the Company followed the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees to account for the issuance

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

of stock incentives to employees and directors. Accordingly, no compensation expense was recognized for equity compensation awards granted with no intrinsic value and the proforma disclosures required by SFAS 123 were presented in the notes to the Company s consolidated financial statements.

As a result of the adoption of SFAS 123R, the Company s income before taxes as reported in the Consolidated Statements of Income for the three and nine months ended September 30, 2006, was $0.6 million and $1.2 million lower, respectively, than under the previous accounting method for stock-based compensation. In addition, basic net income per share for the three and nine months ended September 30, 2006 was $.04 and $.09 lower, respectively, and diluted net income per share was $.04 and $.08 lower, respectively, than under the previous accounting method. SFAS 123R also requires that the benefits of tax deductions in excess of recognized compensation expense be reported as a component of cash flows from financing activities in the Consolidated Statements of Cash Flows. This change increased cash flows provided by financing activities by $1.0 million and reduced cash flows provided by operating activities by the same amount during the nine months ended September 30, 2006. Compensation cost not yet recognized as of September 30, 2006 related to nonvested awards totaled $2.4 million, which is expected to be recognized over a weighted average period of 1.27 years.

Results of Operations

Revenues. Revenues decreased 11% to $24.8 million and increased 2% to $72.7 million for the three and nine months ended September 30, 2006, respectively, from $28.0 million and $71.1 million for the respective prior-year periods. Revenues for the both the quarterly and year-to-date periods were impacted by a decrease in the volume of sales of Producer product line equipment of $4.3 million and $5.1 million, respectively. Driving the decline in Producer product line sales was the shipment in the prior year s third quarter of a $6.0 million Producer equipment order related to the Company s product rollout into the U.S. retail market. The volume of recurring revenues, consisting of sales of media kits, blank CD-R and DVD-R media, printer ribbons, ink cartridges, parts and maintenance contracts, increased $1.5 million and $6.9 million for the three and nine months ended September 30, 2006, respectively, offsetting the year-to-date decline in Producer product equipment sales. 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. Sales of desktop product line equipment decreased $0.3 million and $0.2 million in the third quarter and year-to-date periods in 2006, respectively, impacted by a stronger volume of sales in the prior year periods of the Rimage 360i desktop product, released in April 2005.

International sales decreased 9% for the third quarter and increased 4% for the year-to-date period compared to the same prior year periods. The third quarter reduction in international sales was impacted primarily by lower sales in Latin America, due to stronger than normal sales in the prior year s third quarter. International sales comprised 29% and 33% of total sales for the three and nine months ended September 30, 2006, respectively, compared with 28% and 33% for the same periods in the prior year. The European market continued to generate the majority of international sales. Sales in Asian markets continue to increase, reflecting increased sales efforts in this region

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

with the establishment of a subsidiary operation in Japan in 2005. Currency fluctuations affecting the Company s European and Japanese operations increased reported consolidated revenues for the three months ended September 30, 2006 by 1%, and decreased reported consolidated revenues for the nine months ended September 30, 2006 by less than 1%.

As of and for the nine months ended September 30, 2006, foreign revenues from unaffiliated customers generated by the Company s German and Japanese operations and the operating income and net identifiable assets of such operations were $20.9 million, $0.3 million and $7.5 million, respectively. These amounts related primarily to the Company s German operations, as the establishment of subsidiary operations in Japan occurred in June 2005. Comparable amounts for the Company s German and Japanese operations as of and for the nine months ended September 30, 2005 were revenues of $19.3 million, operating income of $0.6 million and net identifiable assets of $6.9 million. The growth in revenues and assets is due to increasing penetration in foreign markets of sales of CD-R and DVD-R products.

The Company is estimating that fourth quarter 2006 consolidated revenues will range between $23 million and $25 million.

Gross profit. Gross profit as a percentage of revenues was 49% and 46% for the three and nine months ended September 30, 2006, respectively, compared to 48% and 46% for the respective prior year periods. The volume and concentration of Producer product line equipment sales, which generally carry higher margins than desktop product line equipment or recurring revenues, decreased during the three and nine months ended September 30, 2006, due primarily to the impact of the large shipment of Producer product line equipment into the U.S. retail market during the third quarter of 2005. Producer product line equipment sales comprised 46% and 44% of total sales for the three and nine months ended September 30, 2006, compared to 56% and 52% in the same prior year periods. The volume and concentration of recurring revenues, which generally carry lower margins than equipment sales, increased during the current year periods, comprising 45% and 46% of total revenues for the three and nine months ended September 30, 2006, compared to 35% and 37% in the same prior year periods. In spite of the described changes in product mix, the third quarter gross margin improved by one percentage point relative to the same prior year period as a result of the benefit of reduced manufacturing overhead costs and improved service related margins. Additionally, equipment revenues in the current year s third quarter were more concentrated in higher margin transactions, some of which were impacted by higher average selling prices for some Producer equipment configurations. The third quarter change in revenue mix and higher average selling prices for Producer product line equipment also favorably impacted gross profit as a percentage of revenues for the year-to-date period. Offsetting this benefit was the impact of increased manufacturing and service labor and overhead costs for the year-to-date period stemming from increased investments in these areas to support an expected continued growth in total sales. Stock-based compensation expense included in cost of revenue for the three and nine months ended September 30, 2006 had a minimal impact on gross profit as a percentage of revenues, and amounted to $25,000 and $57,000, respectively.

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

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

growth of service related revenues relative to associated service support costs, foreign currency exchange rate fluctuations and levels of sales returns.

Operating expenses. Research and development expenses totaled $1.5 million and $4.8 million for the three and nine months ended September 30, 2006, respectively, representing approximately 6% and 7% of revenues, respectively. Expenses for the same prior year periods totaled $1.4 million and $4.2 million, representing 5% and 6% of revenues, respectively. The 4% and 14% respective increases in expenses for the three and nine months ended September 30, 2006 were primarily due to continued development of new products and enhancements to existing products. Research and development expenses for the three and nine months ended September 30, 2006 were minimally impacted by stock-based compensation expense of $41,000 and $122,000, respectively.

Rimage anticipates continued expenditures in research and development in 2006 to support new product development initiatives and to improve existing products.

Selling, general and administrative expenses for the three and nine months ended September 30, 2006 were 20% and 22% of revenues at $5.0 million and $16.1 million, respectively, compared to expenses in the same prior year periods at 21% of revenues, or $5.9 million and $15.1 million, respectively.

The net changes in selling, general and administrative expenses for the three and nine months ended September 30, 2006 reflect sales and marketing expenses decreasing $0.5 million and $0.7 million, respectively, and general and administrative expenses declining $0.4 million in the third quarter and increasing $1.7 million in the year-to-date period, respectively. 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. The decrease in general and administrative expenses in the quarterly period resulted from $1.1 million of consulting expenses incurred in the prior year s third quarter for the initiation of a strategic analysis of the Company s operations. The strategic analysis continued into and was completed during the first quarter 2006, and $1.2 million of expenses incurred in the first quarter are reflected in year-to-date expenses. Partially offsetting the impact of the reduction in consulting expenses during the three months ended September 30, 2006, and contributing to the growth in year-to-date expenses were $0.3 million and $0.8 million of expenses incurred during the respective periods to support the implementation of a new enterprise resource planning system. Also contributing to the growth in general and administrative expenses for both current year periods were stock-based compensation expenses. Such expenses increased aggregate selling, general and administrative expenses by $0.6 million and $1.0 million for the three and nine months ended September 30, 2006, respectively.

Other income, net. The Company recognized net interest income on cash investments of $0.7 million and $2.0 million for the three and nine months ended September 30, 2006, compared to $0.4 million and $1.0 million for the same prior year periods. The increase in the quarterly and year-to-date periods was due to a $13 million increase in both periods in average cash equivalent and marketable securities balances and an increase in effective yields.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Income taxes. The provision for income taxes represents federal, state and foreign income taxes on income. Income tax expense for the three and nine months ended September 30, 2006 amounted to $2.1 million and $5.2 million, or 31.8% and 35.5% of income before taxes, respectively. Income tax expense for the three and nine months ended September 30, 2005 was $2.3 million and $5.2 million, or 36.3% and 36.5% of income before taxes, respectively. The decrease in the effective tax rates for the three and nine months ended September 30, 2006 primarily reflects the benefit of increased tax-exempt interest income, including the impact of out-of-period tax adjustments for such interest income approximating $0.2 million, and reductions in the tax contingency reserve for the elimination of exposure items included in prior years tax reserves. The Company anticipates its effective tax rate will range between 36% and 37% for the full year 2006.

Net income / net income per share. Resulting net income for the three and nine months ended September 30, 2006 was $4.4 million, or 18% of revenues, and $9.5 million, or 13% of revenues, respectively. Comparable amounts for the three and nine months ended September 30, 2005 were net income of $4.1 million, or 15% of revenues, and $9.1 million, or 13% of revenues, respectively. Related net income per diluted share amounts for the three and nine months ended September 30, 2006 were $0.43 and $0.92, respectively, compared to $0.39 and $0.88 per diluted share for the respective prior year periods. The Company expects fourth quarter 2006 net income to range from $0.23 to $0.28 per diluted share.

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. This credit agreement allows for advances under an unsecured revolving loan up to a maximum advance of $10 million. At September 30, 2006, no amounts were outstanding under the credit agreement.

At September 30, 2006, the Company had working capital of $61.3 million, a decrease of $12.7 million from working capital reported at December 31, 2005. The decline was primarily impacted by the purchase of $25.1 million of non-current marketable securities and capital expenditures of $2.5 million, partially offset by year-to-date net income of $9.5 million and proceeds from employee stock plans of $1.8 million. The Company intends on utilizing its current assets primarily for its continued organic growth. To help strengthen the Company s ability to manage anticipated future growth, the Company expects to invest approximately $4 million in 2006 and early 2007 for the implementation of an enterprise resource planning system in its U.S. and German operations. Additionally, the Company may use its available cash for potential future strategic initiatives or alliances.

Net cash provided by operating activities totaled $8.2 million for the nine months ended September 30, 2006, compared to $9.2 million in the same prior year period. The $1.0 million decrease in cash generated from operations was primarily impacted by a $1.8 million increase in net income adjusted for non-cash items, offset by a $1.8 million larger use of cash from changes in operating assets and liabilities and the impact of a $1.0 million non-cash reduction in operating cash flows associated with excess tax benefits recognized as an addition to the APIC (additional paid-in capital) pool

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

under SFAS 123R. SFAS 123R requires such amounts to be reported as an addition to financing activities and a reduction in operating activities in the Statements of Cash Flows. Primarily contributing to the change in operating assets and liabilities compared to the prior year s year-to-date period was a $4.5 million variation in the change in accounts payable, accrued compensation and accrued expenses, partially offset by a $2.4 million smaller increase in accounts receivable. The change in accounts payable, accrued compensation and accrued expenses resulted from a $2.7 million reduction in these accounts in the current year s period, compared to a $1.8 million increase in the prior year s period. The current period reductions in the accounts payable and accrued expense accounts were impacted by the payment of $1.8 million of consulting fees accrued at December 31, 2005, and the timing of payroll and vendor payments. Additionally, accounts payable at September 30, 2005 included an accrual for $1.1 million of consulting fees incurred in the third quarter 2005. The smaller increase in accounts receivable in the current year s period was impacted by a $3.2 million reduction in revenue in the third quarter 2006 relative to the prior year s third quarter.

Investing activities resulted in a small net use of cash of $0.03 million for the nine months ended September 30, 2006, and provided a net increase in cash of $6.1 million for the same prior year period. The decrease in cash from investing activities relative to the prior year s period was the result of a $5.0 million increase in purchases of marketable securities, net of related maturities of marketable securities, and a $1.3 million increase in capital expenditures. Capital expenditures for the nine months ended September 30, 2006 totaled $2.5 million, and 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 during the year-to-date period for the enterprise resource planning system amounted to $1.6 million, and consisted of system software, hardware and software development costs required to be capitalized under Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.

Net cash provided by financing activities totaled $2.8 million and $1.3 million for the nine months ended September 30, 2006 and 2005, respectively. Financing activities in each period included proceeds from stock option exercises and purchases under the Company s Employee Stock Purchase Plan of $1.8 million and $1.3 million, respectively. Additionally, the current year period includes $1.0 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.

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 accounting policies described below 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, in the second quarter 2006 the Company added a new critical accounting policy for its accounting for stock-based compensation, discussed below. Management made no changes to the Company s critical accounting policies during the third quarter 2006.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

In applying the critical accounting policies described below, management reassesses its estimates each reporting period based on available information. Changes in such estimates did not have a significant impact on earnings for the three and nine months ended September 30, 2006.

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 SAB 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 (commencing once the period covered by standard warranty expires).

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

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

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.

Inventory Reserves. The Company records reserves for inventory shrinkage and for potentially excess, obsolete and slow moving inventory. The amounts of these reserves are based upon 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.

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 warranty claims at the time of sale. 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 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 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

Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

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 Condensed Consolidated Financial Statements in this Form 10Q for additional information on stock-based compensation.

Recently Issued Accounting Standards

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 is currently evaluating the impact of adopting this pronouncement on its consolidated financial statements and related disclosures.

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 Company is currently evaluating the impact of adopting SAB 108 on its consolidated financial statements.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements that involve risks and uncertainties. For this purpose, any statements contained in this report that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, words such as may, will, expect, believe, anticipate, estimate or continue or comparable terminology are intended to identify forward-looking statements statements by their nature involve substantial risks and uncertainties. The Company s actual results could differ significantly from those discussed in the forward-looking statements.

Factors that could cause or contribute to such differences include, but are not limited to, the following, as well as other factors not now identified: the Company s ability to keep pace with changes in technology in the computer and storage media industries as well as technology changes in the retail, medical, banking, government and office markets; increasing competition and the ability of the Company s products to successfully compete with products of competitors and newly developed media storage products; the ability of the Company s newly developed products to gain acceptance and compete against products in their markets, the significance of the Company s international operations and the risks associated with international operations including currency fluctuations, local economic health and management of these operations over long distances; the Company s ability to protect its intellectual property and to defend claims of others relating to its intellectual property; the Company s dependence upon the selling efforts of the Company s key channel partners; the Company s ability to maintain adequate inventory of products; the Company s reliance on single source suppliers; the ability of the Company s products to operate effectively with the computer products developed and to be developed by other manufacturers; the negative effect upon the Company s business from manufacturing or design defects; the effect of U.S. and international regulation, including the costs of implementing and complying with new regulations enacted in various countries requiring the reduction of hazardous substances in electrical and electronic equipment, including the European Union Waste Electrical and Electronic Equipment Directive and Restriction of Hazardous Substances Directive; fluctuations in the Company s operating results; the Company s dependence upon its key personnel; the volatility of the price of the Company s common stock; provisions governing the Company relating to a change of control, compliance with corporate governance and securities disclosures rules and other risks, including those set forth in the Company s reports filed with the Securities and Exchange Commission, including Item 1A of Part I of the Company s Annual Report on Form 10-K for the year ended December 31, 2005. These forward-looking statements are made as of the date of this report and the Company assumes no obligation to update such forward-looking statements, or to update the reasons why actual results could differ materially from those anticipated in such forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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 and Rimage Japan, respectively, are translated into U.S. dollars for consolidation. Resulting translation adjustments are recorded as a separate component of stockholders equity.

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 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.

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Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company s Chief Executive Officer, Bernard P. Aldrich, and the Company s Chief Financial Officer, Robert M. Wolf, have evaluated the Company s disclosure controls and procedures as of the end of the period covered by this report. Based upon such evaluation, they have concluded that these disclosure controls and procedures are effective.

(b) Changes in Internal Control Over Financial Reporting

There have been no changes in internal controls over financial reporting that occurred during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting**.**

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Not Applicable.

Item 1A. Risk Factors

Not Applicable.

Item 2. Changes in Securities and Use of Proceeds

Not Applicable.

Item 3. Defaults Upon Senior Securities

Not Applicable.

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

Not Applicable.

Item 5. Other Information

Not Applicable

Item 6. Exhibits

(a) The following exhibits are included herein:

31.1 Certificate of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Exchange Act.

31.2 Certificate of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Exchange Act.

32 Certifications pursuant to 18 U.S.C. §1350.

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SIGNATURES

In accordance with the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

RIMAGE CORPORATION
Registrant

Date: November 7, 2006 By: /s/ Bernard P. Aldrich

Bernard P. Aldrich
Director, Chief Executive Officer,
and President
(Principal Executive Officer)

Date: November 7, 2006 By: /s/ Robert M. Wolf

Robert M. Wolf
Chief Financial Officer
(Principal Financial Officer)
(Principal Accounting Officer)