RIMAGE CORP
Form 10-Q
November 08, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED
September 30, 2010; OR

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: 000-20728

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)

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** **No**

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). **Yes** **No**

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

Large Accelerated Filer **Accelerated Filer** **Non-Accelerated Filer** **Smaller Reporting Company**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): **Yes** **No**

Common Stock outstanding at October 31, 2010 -- 9,559,733 shares of $.01 par value Common Stock.

RIMAGE CORPORATION
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FOR THE QUARTER ENDED SEPTEMBER 30, 2010

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

RIMAGE CORPORATION AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(unaudited - in thousands, except share data)

Assets	September 30, 2010	December 31, 2009
Current assets:		
Cash and cash equivalents	$ 96,879	$ 72,507
Marketable securities	9,682	28,581
Receivables, net of allowance for doubtful accounts and sales returns of $328 and $327, respectively	14,412	13,732
Inventories	5,600	4,123
Prepaid expenses and other current assets	942	1,271
Deferred income taxes - current	566	546
Total current assets	128,081	120,760
Marketable securities - non-current	6,716	9,037
Property and equipment, net	7,837	7,855
Deferred income taxes - non-current	2,438	2,630
Other assets - non-current	230	
Total assets	$ 145,302	$ 140,282
Liabilities and Stockholders Equity		
Current liabilities:		
Trade accounts payable	$ 5,889	$ 6,898
Accrued compensation	3,500	3,834
Other accrued expenses	719	911
Income taxes payable	50	222
Deferred income and customer deposits	6,092	5,706
Other current liabilities	57	18
Total current liabilities	16,307	17,589
Long-term liabilities:		
Deferred income and customer deposits - non-current	1,437	2,452
Income taxes payable - non-current	205	213
Other non-current liabilities	66	79
Total long-term liabilities	1,708	2,744
Total liabilities	18,015	20,333
Stockholders equity:		
Rimage 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 9,551,087 and 9,471,885 respectively	96	94
Additional paid-in capital	42,269	40,296
Retained earnings	83,857	78,782
Accumulated other comprehensive income	507	777
Total Rimage stockholders equity	126,729	119,949
Noncontrolling interest	558	
Total stockholders equity	127,287	119,949
Total liabilities and stockholders equity	$ 145,302	$ 140,282

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenues:				
Product	$ 20,948	$ 19,731	$ 56,601	$ 52,224
Service	2,419	2,634	7,439	8,317
Total revenues	23,367	22,365	64,040	60,541
Cost of revenues:				
Product	9,912	9,401	27,525	26,142
Service	1,763	1,867	5,536	5,549
Total cost of revenues	11,675	11,268	33,061	31,691
Gross profit	11,692	11,097	30,979	28,850
Operating expenses:				
Research and development	1,796	1,514	4,654	4,990
Selling, general and administrative	6,412	5,009	18,709	15,499
Total operating expenses	8,208	6,523	23,363	20,489
Operating income	3,484	4,574	7,616	8,361
Other income (expense):				
Interest, net	110	309	406	1,323
Realized gain on sale of marketable securities				278
Gain on currency exchange	38	5	6	47
Other, net		(4)	4	(5)
Total other income, net	148	310	416	1,643
Income before income taxes	3,632	4,884	8,032	10,004
Income tax expense	1,335	1,775	2,987	3,737
Net income	2,297	3,109	5,045	6,267
Net loss attributable to the noncontrolling interest	30		30	
Net income attributable to Rimage	$ 2,327	$ 3,109	$ 5,075	$ 6,267
Net income per basic share	$ 0.24	$ 0.33	$ 0.53	$ 0.67
Net income per diluted share	$ 0.24	$ 0.33	$ 0.53	$ 0.66
Basic weighted average shares outstanding	9,559	9,376	9,522	9,364
Diluted weighted average shares outstanding	9,621	9,564	9,600	9,494

See accompanying notes to condensed consolidated financial statements.

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

	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Cash flows from operating activities:		
Net income	$ 5,045	$ 6,267
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,445	897
Deferred income tax benefit	252	(305)
Gain on sale of marketable securities		(278)
Loss on disposal of property and equipment	5	2
Stock-based compensation	1,486	1,213
Excess tax benefits from stock-based compensation	(21)	
Changes in operating assets and liabilities:		
Receivables	(868)	(3,252)
Inventories	(1,480)	1,506
Prepaid income taxes/income taxes payable	(226)	659
Prepaid expenses and other current assets	124	991
Trade accounts payable	1,454	790
Accrued compensation	(203)	840
Other accrued expenses and other current liabilities	(321)	(28)
Deferred income and customer deposits	(646)	2,598
Net cash provided by operating activities	6,046	11,900
Cash flows from investing activities:		
Purchases of marketable securities		(58,119)
Maturities and sales of marketable securities	21,013	43,460
Purchases of property and equipment	(3,817)	(208)
Net cash provided by (used in) investing activities	17,196	(14,867)
Cash flows from financing activities:		
Contribution from noncontrolling interest	588	
Principal payments on capital lease obligations	(14)	(19)
Excess tax benefits from stock-based compensation	21	
Proceeds from stock option exercises	536	284
Net cash provided by financing activities	1,131	265
Effect of exchange rate changes on cash	(1)	142
Net increase (decrease) in cash and cash equivalents	24,372	(2,560)
Cash and cash equivalents, beginning of period	72,507	14,885
Cash and cash equivalents, end of period	$ 96,879	$ 12,325
Supplemental disclosures of net cash paid during the period for:		
Income taxes	$ 3,014	$ 2,980

See accompanying notes to condensed consolidated financial statements.

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

(1) Basis of Presentation and Nature of Business

Rimage Corporation (the Company or Rimage) develops, manufactures and markets workflow-integrated digital publishing solutions that are used by businesses to produce CD/DVD/Blu-ray discs with customized content and durable disc labeling. Rimage distributes its publishing systems from its operations in the United States, Germany, Japan, and effective in the third quarter 2010, from its joint venture operation in China. The Company also distributes related consumables for use with its systems, consisting of media kits, ribbons, ink cartridges and Rimage-branded blank CD-R, DVD-R and Blu-ray media.

The accompanying condensed consolidated financial statements 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 as of and for the year ended December 31, 2009.

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 estimates on items such as allowance for doubtful accounts and sales returns, inventory provisions, asset impairment charges, deferred tax asset valuation allowances, accruals for uncertain tax positions and warranty accruals. These estimates and assumptions are based on management s best judgment. Management evaluates estimates and assumptions on an ongoing basis using its technical knowledge, historical experience and other factors, including consideration of the impact of the current economic environment. Management believes its assumptions are reasonable in light of the current economic environment. Management adjusts such estimates and assumptions when facts and circumstances change. Illiquid credit markets, volatile equity, foreign currency and energy markets, and declines in business and consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

(2) Stock-Based Compensation

In May 2007, the Company s shareholders approved the 2007 Stock Incentive Plan (the 2007 Plan). The 2007 Plan provides for the grant of stock incentive awards in the form of incentive and non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance stock, performance units and other awards in stock and/or cash to certain key employees, non-employee directors and service providers. In May 2009, the Company s shareholders approved amendments to the 2007 Plan, including an increase in the number of shares authorized for issuance by 500,000

RIMAGE CORPORATION AND SUBSIDIARIES
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shares to a total of 1,230,320 shares. At September 30, 2010, a total of 420,808 shares were available for future grant under the 2007 Plan, as amended. Effective with the approval of the 2007 Plan in May 2007, the Company may not issue any new awards or options under its Amended and Restated 1992 Stock Option Plan (the 1992 Plan). The exercise price of stock options granted under the 2007 Plan is equal to the market value on the date of grant. Options issued to employees through March 31, 2006 under the 1992 Plan 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 under both the 1992 Plan and the 2007 Plan generally become exercisable over a four-year period. Options issued to employees through May 13, 2008 under the 1992 Plan and the 2007 Plan terminate ten years from the date of grant, while options issued effective May 14, 2008 under the 2007 Plan terminate seven 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. Restricted stock and restricted stock unit awards issued to employees and non-employee directors under the 2007 Plan are subject to the risk of forfeiture and transfer restrictions that lapse in varying time periods from the date of grant.

In addition to awards granted under the 2007 Plan and 1992 Plan, the Company granted a non-qualified option to purchase 200,000 shares of its common stock to a newly hired executive officer on April 1, 2009. The option was granted outside of any shareholder-approved plan as an inducement to accept employment with the Company. The option has an exercise price equal to the closing price of the Company s common stock as reported by the Nasdaq Stock Market on the first day of employment of April 1, 2009, vests in four equal installments on each of the first four anniversaries of the date of grant and has a term of seven years. In other respects, the option was structured to mirror the terms of options granted under the 2007 Plan and is subject to a stock option plan between the Company and the executive officer.

Under the guidance of the Stock Compensation Topic of the Codification, stock-based compensation expense is determined based on the grant-date fair value and is recognized on a straight-line basis over the vesting period for each stock-based award granted on or after January 1, 2006, and for previously granted awards not yet vested as of January 1, 2006. 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. Compensation cost is recognized for all awards over the vesting period to the extent the employees or directors meet the requisite service requirements, whether or not the award is ultimately exercised. Conversely, when an employee or director does not meet the requisite service requirements and forfeits the award prior to vesting, any compensation expense previously recognized for the award is reversed. The Company recognized stock-based compensation costs of $484,000 and $1,486,000 for the three and nine months ended September 30, 2010, respectively, compared to $413,000 and $1,212,000 for the comparable periods in 2009.

The fair value of each option award is estimated at the date of grant using the Black-Scholes option pricing model. The following key assumptions were utilized in valuing option awards issued during the nine months ended September 30, 2010 and 2009:

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	Nine Months Ended September, 2010	2009
Expected life of options in years	4.75	4.75
Risk-free interest rate	1.6% - 2.65%	1.6% - 2.2%
Expected volatility	49.2% - 49.6%	48.5% - 49.7%
Expected dividend yield	0.0%	0.0%

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 represents the period that the stock option awards are expected to be outstanding. Effective April 2008, the Company s Board of Directors approved a change in the contractual term of stock options granted to employees from ten to seven years. Given the reduction in the contractual term of its employee stock option awards, the Company determined it was unable to rely on its historical exercise data as a basis for estimating the expected life of stock options granted to employees subsequent to this change. As such, the Company used the simplified method for determining the expected life of stock options granted to employees in 2008, 2009 and 2010, as specified by Staff Accounting Bulletin (SAB) No. 107, Valuation of Share-Based Payment Arrangements for Public Companies, which bases the expected life calculation on the average of the vesting term and the contractual term of the awards. The risk-free 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.

Other information pertaining to stock options is as follows:

	Three Months Ended September 30, 2010 (in thousands, except per share data)	2009	Nine Months Ended September 30, 2010 (in thousands, except per share data)	2009
Number of options granted	67	50	284	400
Fair value of options granted	$ 488	$ 352	$ 2,138	$ 2,503
Per share weighted average fair value of options granted	$ 7.23	$ 7.03	$ 7.52	$ 6.25
Total fair value of stock options vested	$ 84	$	$ 1,053	$ 949
Total intrinsic value of stock options exercised	$	$	$ 528	$ 151
Total intrinsic value of stock options outstanding	$ 1,676	$ 3,163	$ 1,676	$ 3,163

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Cash received from the exercise of stock options was $536,000 and $284,000 for the nine months ended September 30, 2010 and 2009, respectively. The exercise of stock options, expirations of vested stock options and lapse of restrictions on restricted stock generated a net non-deductible income tax impact of $48,000 and $70,000 during the nine months ended September 30, 2010 and 2009, respectively. The income tax impact was recorded as a reduction to additional paid-in capital.

(3) Accounting for Uncertainty in Income Taxes

Gross unrecognized tax benefits recorded under the guidance of the Income Taxes Topic of the Codification as of September 30, 2010 and December 31, 2009 totaled $350,000 and $364,000, respectively (excluding interest and penalties). Changes in gross unrecognized tax benefits during the nine months ended September 30, 2010 consisted primarily of a net increase of $16,000 for tax positions taken in the current year and a net decrease of $29,000 for tax positions taken in prior years. Included in the balance of unrecognized tax benefits at September 30, 2010 are potential benefits of $143,000 that if recognized, would affect the effective tax rate. The difference between this amount and the corresponding amount of gross unrecognized tax benefits relates primarily to deferred federal benefits of uncertain tax positions. The Company made no other material adjustments to its unrecognized tax benefits during the nine months ended September 30, 2010.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense. Total accrued interest and penalties amounted to $42,000 and $36,000 on a gross basis at September 30, 2010 and December 31, 2009, respectively, and are excluded from the gross amounts of unrecognized tax benefits reflected above.

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. As of September 30, 2010, the Company was no longer subject to income tax examinations for taxable years before 2007 and 2005 in the case of U.S. federal and German taxing authorities, respectively, and taxable years generally before 2005 in the case of state taxing authorities, consisting primarily of Minnesota, California and Maryland.

(4) Marketable Securities

Marketable securities consist primarily of U.S. treasury bills, money market securities, municipal securities, corporate securities and U.S. government agency securities with long-term credit ratings of AAA and short-term credit ratings of A-1. Marketable securities are classified as either short-term or long-term in the consolidated balance sheet based on their effective maturity date. All marketable securities have original maturities ranging from three to 36 months. Marketable securities 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 until realized. See Note 8, Fair Value Measurements, for a discussion of inputs used to measure the fair value of the Company s available-for-sale securities. The Company s marketable securities at September 30, 2010 did not include any auction-rate securities, high-yield sub-prime backed paper or other affected securities which are subject to significant market value declines or liquidity issues.

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(5) Inventories

Inventories consisted of the following (in thousands):

	September 30, 2010	December 31, 2009
Finished goods and demonstration equipment	$ 1,794	$ 1,425
Purchased parts and subassemblies	3,806	2,698
	$ 5,600	$ 4,123

(6) Comprehensive Income

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	$ 2,327	$ 3,109	$ 5,075	$ 6,267
Other comprehensive income:				
Net changes in:				
Foreign currency translation adjustments	690	298	(144)	128
Change in net unrealized gain on marketable securities, net of taxes	(26)	(57)	(126)	(282)
Total comprehensive income	$ 2,991	$ 3,350		