

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, 1998; 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: 0-20728

RIMAGE CORPORATION

(Exact name of Registrant as specified in its charter)

Minnesota 41-1577970  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

7725 Washington Avenue South, Edina, MN 55439  
(Address of principal executive offices)

612-944-8144  
( 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 November 4, 1998  
-- 3,236,999 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  No

RIMAGE CORPORATION

FORM 10-Q

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FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1998

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RIMAGE CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

September 30, 1998 and December 31, 1997

<TABLE>  
<CAPTION>

Assets	September 30, 1998	December 31, 1997
	(unaudited)	
	<C>	<C>
Current assets:		
Cash and cash equivalents	\$ 4,147,534	\$ 656,127
Trade accounts receivable, net of allowance for doubtful accounts and sales returns of \$314,810 and \$505,458 respectively	5,974,486	4,778,055
Inventories (Note 2)	2,002,116	2,265,867
Income tax receivable	452,621	23,350
Deferred income taxes (Note 6)	750,000	-
Prepaid expenses and other current assets	166,781	472,728
Total current assets	13,493,538	8,196,127
Property and equipment, net	943,798	5,846,953
Goodwill, net	788,156	848,692
Other noncurrent assets	64,496	271,740
Total assets	\$ 15,289,988	\$ 15,163,512

Liabilities and Stockholders' Equity

Current liabilities:		
Current portion of notes payable	\$ -	\$ 900,000
Current installments of capital lease obligations (note 4)	-	356,053
Trade accounts payable	2,477,914	2,789,973
Accrued expenses	1,471,506	1,069,315
Deferred income and customer deposits	610,973	640,725
Total current liabilities	4,560,393	5,756,066
Notes payable, less current portion	-	750,000
Capital lease obligations, less current installments (note 4)	-	2,661,334
Total liabilities	4,560,393	9,167,400

Minority interest in inactive subsidiary	-	57,907
--	---	--------

Stockholders' equity:

Common stock, \$.01 par value, authorized 10,000,000 shares, issued and outstanding 3,236,999 and 3,091,302, respectively	32,370	30,913
Additional paid-in capital	11,404,770	10,468,136
Accumulated deficit	(681,484)	(4,405,218)
Foreign currency translation adjustment	(26,061)	(155,626)

-----  
Total stockholders' equity 10,729,595 5,938,205  
-----

-----  
Total liabilities and stockholders' equity \$ 15,289,988 \$ 15,163,512  
=====

See accompanying condensed notes to consolidated financial statements

</TABLE>

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RIMAGE CORPORATION AND SUBSIDIARIES  
Consolidated Statements of Operations

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1998	1997	1998	1997
<S>	<C>	<C>	<C>	<C>
Revenues	\$ 9,225,576	\$ 8,443,604	\$ 27,715,465	\$ 29,608,308
Cost of revenues	5,477,044	5,758,059	16,439,886	21,460,335
Gross profit	3,748,532	2,685,545	11,275,579	8,147,973
Operating expenses:				
Engineering and development	550,764	425,862	1,467,641	1,510,529
Selling, general and administrative	1,687,095	1,606,179	5,635,026	5,044,491
Total operating expenses	2,237,859	2,032,041	7,102,667	6,555,020
Operating earnings	1,510,673	653,504	4,172,912	1,592,953
Other (expense) income:				
Interest, net	22,585	(183,863)	(135,293)	
Gain (loss) on currency exchange	50,728	(10,562)	77,498	28,178
Gain on capital leases (Note 4)	512,192	-	512,192	-
Other, net (Note 5)	(1,017,817)	97,213	(977,738)	112,312
Total other expense, net	(432,312)	(97,212)	(523,341)	
Earnings before income taxes	1,078,361	556,292	3,649,571	1,037,515
Income tax (benefit) expense (Note 6)	(594,363)	29,857	(74,163)	90,000
Net earnings	\$ 1,672,724	\$ 526,435	\$ 3,723,734	\$ 947,515
Basic net earnings per common share	\$ 0.52	\$ 0.17	\$ 1.18	\$ 0.31
Diluted net earnings per common share and common share equivalents	\$ 0.45	\$ 0.16	\$ 1.03	\$ 0.29

Basic weighted average shares	3,218,632	3,085,701	3,151,921	3,084,905
=====				
Diluted weighted average shares and common share equivalents outstanding	3,731,275	3,283,725	3,614,141	3,224,127
=====				

</TABLE>

See accompanying condensed notes to consolidated financial statements

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RIMAGE CORPORATION AND SUBSIDIARIES  
Consolidated Statements of Cash Flows  
(unaudited)

<TABLE>  
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ended	Nine months	
	1998	September 30, 1997
-----		
<S>	<C>	<C>
Cash flows from operating activities:		
Net earnings	\$ 3,723,734	\$ 947,515
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Minority interest in net earnings of dissolved subsidiary	57,907	-
Depreciation and amortization	1,484,040	1,835,988
Change in reserve for excess and obsolete inventories	166,423	21,787
Change in reserve for allowance for doubtful accounts	(190,648)	(513,050)
Loss on sale of property and equipment	979,583	74,783
Write off of other assets	(15,000)	-
Deferred income tax benefit	(750,000)	-
Gain on capital leases	(512,192)	-
Changes in operating assets and liabilities:		
Trade accounts receivable	(1,005,783)	1,061,478
Inventories	97,328	1,274,825
Income tax receivable	(429,271)	794,079
Prepaid expenses and other current assets	228,178	(100,638)
Trade accounts payable	(312,059)	(1,728,965)
Accrued expenses	326,092	(565,388)
Deferred income and customer deposits	(29,752)	120,420
-----		
Net cash provided by operating activities	3,818,580	3,222,834
-----		
Cash flows from investing activities:		
Purchase of property and equipment	(504,617)	(287,129)
Proceeds from the sale of property and equipment	2,120,884	16,000
Other noncurrent assets	157,018	183,403
Receipts from sales-type leases	89,782	253,272
-----		
Net cash provided by investing activities	1,863,067	165,546
-----		

(Continued)

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<TABLE>  
<CAPTION>

	Nine months ended September 30,	
	1998	1997
<S>	<C>	<C>
Cash flows from financing activities:		
Proceeds from stock option exercise	938,091	16,005
Principal payments on capital lease obligation	(1,504,878)	(246,028)
Proceeds from other notes payable	-	26,001,642
Repayment of other notes payable	(1,650,000)	(29,189,238)
Net cash used in financing activities	(2,216,787)	(3,417,619)
Effect of exchange rate changes on cash	26,547	(75,233)
Net increase (decrease) in cash	3,491,407	(104,472)
Cash and cash equivalents, beginning of period	656,127	117,322
Cash and cash equivalents, end of period	\$ 4,147,534	\$ 12,850
Supplemental disclosures of net cash received (paid) during the period for:		
Interest	\$ 135,293	\$
(513,388)		
Income taxes	\$ (1,061,900)	\$
(18,186)		
Supplemental disclosures of non-cash investing and financing activities:		
Reduction of obligations under capital leases as a result of conversions to operating leases	\$ 1,512,509	
Reduction of net book value of facilities under capital leases as a result of conversions to operating leases	\$ 1,000,317	

See accompanying condensed notes to the consolidated financial statements

</TABLE>

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

(1) BASIS OF PRESENTATION AND NATURE OF BUSINESS

The consolidated financial statements include the accounts of Rimage Corporation, Rimage Europe GmbH, A/G Systems Inc., d/b/a Duplication Technology Inc. (Rimage Boulder), Knowledge Access International (Knowledge Access) and Rimage Services, collectively hereinafter referred to as Rimage or the Company. All material intercompany accounts and transactions have been eliminated upon consolidation.

The Company operates in two divisions, Rimage Systems Division and Rimage Services Division. The Rimage Systems Division consists of substantially all of the former Rimage Companies. The Rimage Services Division consists of Rimage Services in addition to the existing service business at Rimage Boulder. During the third quarter of 1998, the Company ceased operations of its Bloomington Service division (Rimage Services) and sold the equipment and inventory associated with it.

The Systems Division develops, manufactures and distributes high performance CD-Recordable (CD-R) publishing and duplication systems, and continues to support its long-term involvement in diskette duplication and publishing equipment. The Services

Division provides computer media duplication and production services to software developers and manufacturers and information publishers.

The accompanying unaudited consolidated financial statements of the Company have been prepared pursuant to the rules of the Securities and Exchange Commission. These financial statements should be read in conjunction with the more detailed financial statements and notes thereto included in the Company's most recent annual report on Form 10-K.

The Company extends unsecured credit to its customers as well as credit to a limited number of authorized distributor wholesalers, who in turn provide warehousing, distribution, and credit to a network of authorized value added resellers. These distributors and value added resellers sell and service a variety of hardware and software products.

In the opinion of management, the accompanying consolidated financial statements reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial position and results of operations and cash flows of the Company for the periods presented. Certain previously reported amounts have been reclassified to conform with the current presentation.

(Continued)

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

(1) BASIS OF PRESENTATION AND NATURE OF BUSINESS (CONTINUED)

The preparation of financial statements in conformity with generally accepted accounting principles 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) INVENTORIES

Inventories consist of the following as of:

	September 30, 1998 (unaudited)	December 31, 1997
-----		
Finished goods and demonstration equipment	\$1,053,623	\$ 578,689
Work-in-proces	199,491	234,177
Purchased parts and subassemblies	1,363,425	1,901,001
-----		
	2,616,539	2,713,867
Less reserve for excess inventories	614,423	448,000
-----		
	\$2,002,116	\$2,265,867
-----		

(Continued)

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

(3) SEGMENT REPORTING

The following table summarizes certain financial information for the Systems and Services segments:

Nine Months Ended September 30,  
(unaudited)  
(in thousands)

	1998	1997
-----		
Revenues from unaffiliated customers:		

	Systems	\$20,023	\$ 15,428
	Services	7,693	14,180
		-----	-----
		27,716	29,608
Operating earnings (loss):			
	Systems	4,308	2,125
	Services	(135)	(532)
		----	----
		\$ 4,173	\$ 1,593
		September 30,	December 31,
		1998	1997
		(unaudited)	
-----			
Net identifiable assets:			
	Systems	\$14,785	\$ 7,881
	Services	1,115	7,283
		-----	-----
		\$15,900	\$15,164

(4) CAPITAL LEASES

During September 1998, the Company renegotiated its existing capital leases for both the Edina and Bloomington Minnesota facilities, resulting in operating leases and a gain of \$512,192.

(Continued)

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

(5) SHUT DOWN OF BLOOMINGTON SERVICES OPERATION

In connection with the August 31, 1998 sale of a portion of the Company's services division, the Company sold the fixed assets and inventory used in its Bloomington, Minnesota services operation during the third quarter. From the July 23, 1998 measurement date to September 30, 1998, the Bloomington, Minnesota services operation had income from operations of \$20,155 and generated proceeds of approximately \$2.1 million from the sale of assets used in its operation. The Company has recognized a loss on the sale of these assets during the third quarter totaling approximately \$859,000. The Company filed a Form 8-K dated July 31, 1998 which contained unaudited pro forma condensed consolidated statements of operations for the year ended December 31, 1997 and for the six months ended June 30, 1998 excluding the operations related to the assets of its Bloomington, Minnesota services business, as if the assets had been sold at the beginning of the respective periods. Pro forma consolidated revenues were \$35.7 million and \$17.9 million for the year ended December 31, 1997 and for the six months ended June 30, 1998, respectively. Pro forma consolidated net earnings were \$1.2 million and \$2.1 million for the year ended December 31, 1997 and for the six months ended June 30, 1998, respectively. As of June 30, 1998, pro forma consolidated total assets and total liabilities were \$15.8 and \$7.9 million, respectively.

(6) INCOME TAXES

In accordance with SFAS No. 109, in prior years the Company established a valuation allowance against its net deferred tax asset. A valuation allowance is necessary when, based upon a review of all applicable facts and circumstances, it is more likely than not that the deferred tax asset will not be realized. The Company periodically evaluates the continued need for this valuation allowance. As a result of a review of the Company's current and projected earnings and other positive business factors, the Company believes it is now more likely than not that the deferred tax asset will be realized; therefore, the valuation allowance of \$750,000 was reduced to zero during the third quarter of 1998. The resulting tax benefit of \$750,000 reduced the Company's income tax expense recognized for the three and nine months ended September 30, 1998. (Continued)

(7) COMPREHENSIVE INCOME

In June 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 130, REPORTING COMPREHENSIVE INCOME. This statement requires companies to classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet, and is effective for the Company's year ending December 31, 1998. The Company's only item of other comprehensive income relates to foreign currency translation adjustments, and is presented separately on the balance sheet as required. If presented on the statement of operations for the three and nine months ended September 30, 1998, comprehensive income would be \$1.8 million and \$3.9 million or \$103,968 and \$129,565 more than reported net income, respectively, due to foreign currency translation adjustments.

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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 operations, shown in thousands.

<TABLE>  
 <CAPTION>

	Three months ended September 30,		Nine months ended September 30,	
	1998 <C>	1997 <C>	1998 <C>	1997 <C>
<S>	-----	-----	-----	-----
Revenues:				
Systems .....	\$ 7,290	\$ 4,881	\$ 20,023	\$ 15,428
Services .....	1,936	3,563	7,693	14,180
	-----	-----	-----	-----
Total Revenues .....	9,226	8,444	27,716	29,608
Cost of Revenues:				
Systems .....	3,647	2,670	9,677	8,931
Services .....	1,830	3,088	6,763	12,529
	-----	-----	-----	-----
Total Cost of Revenues .	5,477	5,758	16,440	21,460
Operating Expenses:				
Systems .....	2,003	1,314	6,038	4,372
Services .....	235	718	1,065	2,183
	-----	-----	-----	-----
Total Operating Expenses	2,238	2,032	7,103	6,555
Operating Earnings:				
Systems .....	1,640	898	4,308	2,125
Services .....	(129)	(244)	(135)	(532)
	-----	-----	-----	-----
Total Operating Earnings	\$ 1,511	\$ 654	\$ 4,173	\$ 1,593
	=====	=====	=====	=====

</TABLE>

RESULTS OF OPERATIONS

This report contains forward-looking statements that involve 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, changes in media or method used for distribution of software, technological changes in products offered by the Company or its competitors and changes in general conditions in the computer market.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Rimage operates through two primary divisions: (1) the systems division designs, manufactures and sells high performance, on-demand publishing and duplication equipment for CD-R's, diskettes and tapes, and (2) the services division provides media duplication and fulfillment services for most computer media types, including CD-ROM, diskette, tape and other media such as ZIP and Jazz disks. Results of operations during the three and nine months ended September 30, 1998 reflected the continued trend of substantial growth and profitability in the systems division and lower contribution from the services division.

REVENUE. Revenue increased 9.3% from \$8.4 million during the third quarter of 1997 to \$9.2 million during the third quarter of 1998. The Company's ongoing intent to focus its sales efforts more heavily towards developing the systems division current distribution network created increased sales of its CD-R products. Expanded market penetration caused revenue in the systems division to increase 49.3% to \$7.3 million during the third quarter of 1998 from \$4.9 in the third quarter of 1997. The services division recorded a 45.7% decline in revenue from \$3.6 million in the third quarter of 1997 to \$1.9 million in the third quarter of 1998. Revenue in the services division was affected by the divestiture of its Bloomington, MN services operation and decreasing demand for diskette duplication services.

For the nine months ended September 30, 1998, revenues of \$27.7 million represented a 6.4% decrease as compared to revenues of \$29.6 million during the same period in 1997. However, primarily as a result of continued increasing demand of CD-R related products, systems division revenues increased 29.8% from \$15.4 million during the nine months ended September 30, 1997 to \$20.0 million during the same period in 1998. This increase was offset by services division revenues which decreased 45.7% from \$14.2 million during the nine months ended September 30, 1997 to \$7.7 million during the same period in 1998. Revenue in the services division was affected by the loss of a customer that provided 8.2% of services sales during the first quarter of 1997, by the termination of its Bloomington, MN services operation due to decreasing demand for diskette duplication services, and as a result of the Company's ongoing intent to focus its sales efforts more heavily towards developing the systems division's current distribution network.

As of and for the nine months ended September 30, 1998, foreign revenues from unaffiliated customers, operating earnings, and net identifiable assets were \$5,731,000, \$685,000 and \$3,127,000, respectively. As of and for the nine months ended September 30, 1997, foreign revenues from unaffiliated customers and operating loss were \$3,157,000 and \$178,000. Foreign net identifiable assets as of December 31, 1997 totaled \$2,074,000. The growth is due to significant penetration in the European markets of sales of CD-R products. The Company's CD-R products have been even more rapidly accepted in Europe than in the United States and the Company's European operations continue to grow at a significant rate. The Company sells most of its products in local currencies and is therefore susceptible to fluctuations of currencies against the dollar.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

On August 31, 1998, the Company terminated its Bloomington, Minnesota services operation. The Company recognized a \$859,000 loss on the sale of equipment associated with its Bloomington services operation, which is reflected in other expense during the third quarter 1998. The Bloomington operation, which contributed \$3.9 million to revenue during the nine month period, generated an operating loss of \$84,711. Although the Company anticipates generating increasing revenue in its systems division over the next few quarters, it is unlikely that such revenues will offset the decrease in revenue from termination of the Bloomington services operation.

GROSS PROFIT. Gross profit as a percent of sales was 40.6% during the third quarter of 1998 compared to 31.8% during the same period of 1997 and was 40.7% during the first nine months of 1998 compared to 27.5% during the same period of 1997. Systems division gross profit as a percent of sales was 50.0% during the third quarter of 1998 compared to 45.3% during the same period of 1997 and was 51.7% during the nine month period ended September 30, 1998 compared to 42.1% during the same period of 1997. The increase in total and systems sales during both the three and nine month periods was due to the greater proportion of high margin systems sales in the 1998 periods, primarily sales of CD-R equipment, and to manufacturing efficiencies instituted during the latter half of 1997. Services division gross profit as a percent of sales was 5.5% during the third quarter of 1998 compared to 13.3% during the same period of 1997 and was 12.1% during the first nine months of 1998 compared to 11.6% during the same period in 1997. The decrease during the third quarter is due to the reduced margins experienced in connection with the termination of its Bloomington, Minnesota services operation on August 31, 1998. With the termination of the Bloomington services operation and the resulting increase in the proportion of revenue from the Company's systems division, margins should continue to improve over the next

several quarters.

OPERATING EXPENSES. Operating expenses were \$2.2 million or 24.3% of revenues during the third quarter of 1998 compared to \$2.0 million or 24.1% of revenues for the same period of 1997. Operating expenses increased from \$6.6 million, or 22.1% of revenue, during the nine month period ended September 30, 1997 to \$7.1 million, or 25.6% of revenue, during the same period of 1998. Most of the increase in operating expenses related to increased sales and marketing expenses. During 1998, the Company continued to expand its distribution network, both domestically and internationally, for its systems products and has focused efforts on the promotion of joint marketing campaigns with distributors and value added resellers. These steps, combined with the increasing percentage of overall sales from the systems division (where products are sold through distribution) as opposed to services (where services are generated primarily through contacts and advertisement) were primary causes of sales and marketing expense to increase from \$702,000 or 8.3% of revenue in the third quarter of 1997 to \$1,273,000 or 13.8% of revenue in the third quarter of 1998 and from \$2.7 million or 9.0% of revenue during the nine months ended September 30, 1997 to \$3.8 million or 13.9% of revenue during the same period of 1998. Partially offsetting the increased sales and marketing expense was a decrease in general and administrative expense due to the consolidation of certain administrative duties. Research and development expense remained relatively constant during both the three and nine month comparative periods, but decreased slightly as a percentage of revenue because of higher sales. One of the Company's principal objectives is to continue to reduce

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

expenditures in administration as a percentage of revenue and direct more resources to research and development activities and towards revenue producing activities through selling and marketing expense. Accordingly, the Company intends to continue spending in research and development and sales and marketing. With the termination of the Bloomington services operation, the Company anticipates that both general and administrative expenses and sales and marketing expenses will increase as a percent of revenues.

INTEREST. The Company repaid all outstanding borrowings under its line of credit during the fourth quarter of 1997. Furthermore, the Company's cash position at June 30 enabled it to extinguish the outstanding balance of its Term Note with the bank in the amount of \$1.2 million and to eliminate debt associated with a capital lease on certain CD-ROM equipment in the amount of \$1.4 million. These transactions contributed to the Company recognizing net interest income of \$23,000 during the third quarter of 1998. Net interest expense during the third quarter of 1997 totaled \$184,000. Also, in September 1998, the Company renegotiated its existing capital leases for both the Edina and Bloomington Minnesota facilities, resulting in operating leases and the elimination of future interest expense. As a result of these transactions, the Company anticipates recognizing interest income for the balance of the year.

INCOME TAXES. The provision for income taxes represents federal, state, and foreign income taxes on earnings before income taxes. Income tax (benefit) expense for the third quarter of 1998 amounted to \$(594,000) as compared to \$30,000 for the third quarter of 1997. In accordance with FAS 109, the Company periodically evaluates the need for a valuation allowance against its deferred tax asset. As a result of expected continued earnings, the Company has determined the valuation allowance is no longer necessary. The tax benefit reduced the Company's income tax expense recognized for the three and nine months ended September 30, 1998 by \$750,000. Hereafter, the Company's operating results will be reported on a fully taxed basis.

NET EARNINGS. The significant change in mix of revenue to higher margin product sales in the systems division, combined with only marginal increases in operating expense to support those sales, the gain on the capital lease restructurings coupled with the benefit from the elimination of the valuation allowance against its deferred tax asset netted with the loss incurred with the termination of the Company's Bloomington services operation caused net earnings to increase dramatically to \$1.7 million in the third quarter of 1998 and \$3.7 million for the nine month period ended September 30, 1998. The Company expects to continue to emphasize and devote much of its resources to its systems business in coming quarters.

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OPERATIONS (CONTINUED)

LIQUIDITY AND CAPITAL RESOURCES

The Company's balance sheet changed significantly during the third quarter of 1998 through (i) the sale of substantially all of the assets associated with the Company's Bloomington, Minnesota services operation, generating proceeds of approximately \$2.1 million, of which approximately \$1.3 million was used to repay debt associated with certain equipment under a capital lease and generating a loss on the sale of property totaling \$859,000; (ii) the renegotiations of leases previously accounted for as capital leases and the classification of the new leases as operating leases resulting in the elimination of debt totaling \$1.5 million and generating a gain of \$512,000; and (iii) the elimination of a valuation allowance against the Company's deferred tax asset that generated a deferred tax benefit of \$750,000 during the third quarter of 1998.

Operating activities generated \$3.8 million of cash during the nine months ended September 30, 1998. This amount consisted of \$4.9 million of cash generated from net earnings after adjustment for non-cash items. These non-cash items consisted of depreciation and amortization, the loss on the sale of equipment (majority of which was used in the Bloomington services operation), and the deferred income tax benefit recognized as a result of the Company's elimination of its valuation allowance against its deferred tax asset.

Investing activities generated \$1.9 million of cash during the nine months ended September 30, 1998, as the Company received cash proceeds from the sale of fixed assets totaling approximately \$2.1 million. A majority of these proceeds were a result of the sale of equipment used in the Company's Bloomington services operation. The Company invested approximately \$505,000 in additional equipment primarily for manufacturing purposes.

Financing activities consumed \$2.2 million of cash primarily as a result of monthly payments under a term note agreement with its bank and payment of approximately \$1.3 million to extinguish the debt associated with equipment held under a capital lease. The remaining balance of the term note was paid off in July of 1998.

The Company also maintains a revolving credit agreement with the same bank that provides for borrowings of up to \$5,000,000 based on qualifying balances of varying assets. The Company estimates that it had available borrowing authority of approximately \$3.2 million under such line at September 30, 1998 but had no outstanding advances under the line at that date.

The Company believes that the \$4.1 million cash balance at September 30, 1998 and available borrowings under its credit line will be more than adequate to finance operations through 1999.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

The Company believes the approach of the Year 2000 could have a material effect on the Company's business, results of operations, and financial condition if it were to avoid the related consequences. To mitigate these potential consequences, the Company has identified the following areas as requiring significant analysis: 1) manufactured products, 2) information technology applications, 3) information technology end user supported applications, 4) information technology infrastructure, 5) business partners - both vendors and customers, 6) manufacturing equipment, 7) facility operations (non-information technology systems). The Company has also identified five phases associated with each area described above as follows: 1) awareness - educating all levels of the Company about the importance of Year 2000 readiness; 2) assessment - identify all electronic systems which are date-sensitive and assess which systems are not Year 2000 ready; 3) renovation - develop a strategy to repair, replace or retire the system; 4) validation - testing of changed programs and date files to ensure they are Year 2000 ready; and 5) implementation - placing the renovated and validated systems into everyday use. Currently, the Company is in the assessment phase of its plan to prepare itself for the Year 2000. The Company plans to complete this assessment phase by December 5, 1998. The following table describes the Company's estimated completion date for each remaining phase:

Renovation	May 1999
Validation	July 1999
Implementation	August 1999

Through September 30, 1998, the Company has incurred costs of approximately \$75,000 directly attributable to addressing Year 2000 issues. The Company is

unable to, at this time, estimate the remaining costs that will be incurred in connection with its analysis of Year 2000 issues. The following are some of its most reasonably likely worst case Year 2000 scenarios the Company has identified: 1) The Company's manufacturing operations consist primarily of the assembly of products from components purchased from third parties. While some parts are stock "off the shelf" components, others are manufactured to the Company's specifications. Although the Company believes it has identified alternative assembly contractors for most of its subassemblies, an actual change in such contractors, as a result of an inability to work with such contractor due to Year 2000 consequences they face, would likely require a period of training and testing. Accordingly, an interruption in a supply relationship or the production capacity of one or more of such contractors could result in the Company's inability to deliver one or more products for a period of several months. 2) The Company sells most of its manufactured systems through a limited number of authorized distributor wholesalers, who in turn provide warehousing, distribution, and credit to a network of authorized value added resellers. The interruption of product flow to one or more of these distributors due to their inability to process date sensitive information could result in lower than normal sales revenues. To alleviate this decrease, the Company would redirect these sales to the remaining distributors and/or sell directly to its value added resellers.

#### NEW EUROPEAN CURRENCY

On January 1, 1999, eleven of the fifteen member countries of the European Union are scheduled to establish fixed conversion rates between their existing currencies and the euro, a new European currency, and to adopt the euro as their common legal currency (the "Euro Conversion"). Either the euro or a participating country's present currency will be accepted as legal tender from January 1, 1999 to January 1, 2002, from which date forward only the euro will be accepted.

The Company has a fair number of customers located in European Union countries participating in the Euro Conversion. Such customers will likely have to upgrade or modify their computer systems and software to comply with the euro requirements. The amount of money the Company anticipates spending in connection with product development related to the Euro Conversion is not expected to have a material adverse effect on the Company's results of operations or financial condition. The Euro Conversion may also have competitive implications for the Company's pricing and marketing strategies, which could be material in nature; however, any such impact is not known at this time.

The Company has also begun to analyze which of its internal systems (such as payroll, accounting and financial reporting) will need to be modified to deal with the Euro Conversion. The Company does not currently expect the cost of such modifications to have a material effect on the Company's results of operations or financial condition. There is no assurance, however, that all problems related to the Euro Conversion will be foreseen and corrected, or that no material disruptions of the Company's business will occur.

#### PART II -- OTHER INFORMATION

- Item 1. Legal Proceedings  
Not Applicable.
- Item 2. Changes in Securities  
Not Applicable.
- Item 3. Defaults Upon Senior Securities  
Not Applicable.
- Item 4. Submission of Matters to a Vote of Security Holders  
None.
- Item 5. Other Information  
Not Applicable.
- Item 6. Exhibits and Reports on Form 8-K  
(a) Exhibits:

Exhibit No. 10.1 Operating Lease dated September 1,  
1998 for Facility at Edina,

Minnesota location

Exhibit No. 10.2 Operating Lease Dated September 1,  
1998 for Facility at Bloomington,  
Minnesota location

Exhibit No. 11.1 Calculation of Earnings Per Share.

Exhibit No. 27.1 Financial Data Schedule

Exhibit No. 27.2 Financial Data Schedule-Restated

(b) Reports on Form 8-K:

Filed July 31, 1998. Reported the disposition of  
equipment associated with the Company's  
Bloomington services operation. The financial  
information included unaudited pro forma condensed  
consolidated balance sheet as of June 30, 1998 and  
unaudited pro forma condensed consolidated  
statement of operations for the six months ended  
June 30, 1998 and the year ended December 31,  
1997.

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SIGNATURES

In accordance with the Exchange Act, this report has been signed below by  
following persons on behalf of the registrant and on the dates indicated.

RIMAGE CORPORATION  
Registrant

Date: November 11, 1998  
-----

By: /s/ Bernard P. Aldrich  
-----  
Bernard P. Aldrich  
Director, Chief Executive Officer,  
and President  
(Principal Executive Officer)  
(Principal Financial Officer)

Date: November 11, 1998  
-----

By: /s/ Robert M. Wolf  
-----  
Robert M. Wolf  
Controller  
(Principal Accounting Officer)

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## LEASE

7725 Washington Ave. Corp. (Owner/Landlord)	September 1, 1998 (Lease Date)	\$ See Exhibit D (Monthly Base Rent)
Rimage Systems, Inc. (Tenant)	43,000 SF (Unit(s))	\$ None            Paid (Security Deposit)
Washington Avenue Building (Project)	5 years + 2 mos (Term)	\$ _____ Paid (First Month's Rent)
7725 Washington Ave. So. (Address)	September 1, 1998 (Beginning)	\$ _____ Paid (Improvements)
Edina, MN 55439 (City, State, Zip)	December 31, 2003 (Ending)	\$ _____ Paid (Receipt By)

THIS LEASE is made and entered into this 1st day of September, 1998 between 7725 Washington Ave. Corp. with its principal place of business at 7808 Creekridge Circle, Suite 200, Minneapolis, MN 55439 (herein called "Landlord"), and Rimage Systems, Inc. a corporation organized under the laws of the State of Minnesota with its principal business at 7725 Washington Avenue South, Edina, MN 55439 (herein called "Tenant", whether one or more).

## WITNESSETH:

## 1. PREMISES.

In consideration of the obligation of Tenant to pay rent as herein provided, and in consideration of the other terms, provisions and covenants hereof, Landlord hereby leases to Tenant, and Tenant hereby takes from Landlord, certain Premises (herein called the "Premises") situated in the County of Hennepin, State of Minnesota, consisting of approximately 43,000 square feet of gross rentable area outlined in red on the floor plan attached hereto Exhibit A and made a part hereof in the building commonly known as Washington Avenue Building (herein called the "Building") located at 7725 Washington Avenue South, Edina, MN 55439 which building is situated upon the real property described on Exhibit B attached hereto and hereby made a part hereof (the Building and said real property are herein called the "Project"), together with the right to use in common with Landlord and other Tenants in the Project, and their employees, agents, representatives and invitees, any common areas and facilities of the Project and together with the right to use any parking area (herein called the "Shared Parking area") located outside of the Project which is designated by Landlord, by written notice from Landlord to Tenant, as a parking area which Tenant may use in common with other parties designated by Landlord.

## 2. TERM.

This Lease shall be for a term of five (5) years and two (2) months, commencing on September 1, 1998, and expiring on December 31, 2003 with option for additional five (5) years per attached Schedule D.

## 3. WORK LETTER.

Landlord, at its sole cost and expense, shall construct any leasehold improvements required to be by Landlord constructed pursuant to the Work Letter (herein called the "Work Letter") attached hereto as Exhibit C and made a part hereof.

## 4. RENT.

Tenant shall pay Landlord, without deduction or setoff, an annual minimum rental (herein sometimes called "Base Rent of:

See Exhibit D

payable, in advance, without demand, on or before the first day of each and every month during the term hereof; provided, however, that if the term hereof shall commence upon a day other than the first day of a calendar month or expire upon a day other than the last day of the calendar month. Base Rent for the partial calendar month shall be prorated on a per diem basis and shall be paid by Tenant on the commencement date of the term hereof (in the case of an initial partial month) or on the first day of the month in which the term hereof expires

(in the case of a terminal partial month).

5. SECURITY DEPOSIT.

Tenant agrees to deposit with Landlord on the date hereof the sum of

None

which sum shall be held by Landlord, without obligation for interest, as security for the performance of Tenant's covenants and obligations under this Lease, it being expressly understood and agreed that such deposit is not an advance rental deposit or a measure of Landlord's damages in case of Tenant's default. Upon the occurrence of any event of default by Tenant, Landlord may, from time to time without prejudice to any other remedy provided herein or provided by law, use such fund to the extent necessary to make good any areas of rent and any other damage, injury, expense or liability caused by such event of default, and Tenant shall pay to Landlord on demand the amount so applied in order to restore the security deposit to its original amount. If Tenant is not then in default hereunder, any remaining balance of such deposit shall be returned by Landlord to Tenant upon termination of this Lease.

6. USE

Subject to the following provisions of this Paragraph 6, the Premises may be used for any lawful purpose. Tenant shall comply with all governmental laws, ordinances and regulations applicable to the use of the Premises and shall promptly comply with all governmental orders and directives for the correction, prevention and abatement of nuisances in, upon or connected with the Premises, all at Tenant's sole expenses. Tenant shall not receive, store or otherwise handle any product, material or merchandise which is explosive or highly inflammable and will not permit the Premises to be used for any purpose which would render the insurance thereon void or the insurance risk more hazardous, or increase the premiums therefore, and in the event of any such increase by reason of any activity conducted by Tenant in, on or about the Premises, Tenant shall be liable for such increase and shall reimburse Landlord therefor. Tenant shall not store any material or merchandise outside the Premises.

7. OPERATING COSTS.

Prior to the commencement of the term of this Lease and prior to March 1 of each calendar year thereafter, or as soon thereafter as practicable. Landlord shall furnish Tenant with a written statement of the estimated operating costs per square foot of gross rentable area of the Building for such calendar year. During the remainder of such calendar year, Tenant shall pay Landlord at the times that the monthly Base Rent is due and payable hereunder an amount equal to one-twelfth (1/12) of the product of the number of gross square feet in the Premises times such estimate. If Tenant's monthly payment of estimated operating costs is greater than the monthly amount of operating expenses Tenant paid for the then elapsed calendar months of such calendar year, then, within ten (10) days after such written estimate is given. Tenant shall also pay to a Landlord the deficiency for said elapsed calendar months. After the expiration of each calendar year falling in whole or in part within the term hereof. Landlord shall furnish Tenant with a written statement of the actual operating costs of the Project (and, if applicable, the Shared Parking Area) for the preceding calendar year, and if such actual operating costs for such preceding calendar year are more or less than the estimate, an appropriate adjustment shall be made within ten (10) days after such written statement is furnished.

For the purposes hereof, operating costs shall be deemed to mean all taxes (both general and special and whether now or hereafter enacted), assessments or governmental charges levied or assessed against the Project (and, if applicable, the Shared Parking Area) or any part thereof, and all costs which, for federal tax purposes, may be expensed rather than capitalized, and which Landlord will or does incur, pay or become obligated to pay in owning, maintaining, operating and leasing the Project (and, if applicable the Shared Parking Area) and appurtenances thereto, exclusive of interest and depreciation, Without limiting the generality of the foregoing operating costs shall include personal property taxes, fees or permits or licenses, a management fee or fees not to exceed five percent (5%) of the Base Rent, landscaping and gardening cleaning, painting, decorating, paving, lighting, security guards, leasing and maintenance of music and intercom systems. If any, removal of snow, trash, garbage and other refuse, heating, ventilating and air-

conditioning, costs and expenses in connection with meeting federal state, or local environmental energy standards, fire protection, water and sewage and other utility charges not separately metered and charged to particular Tenants, the cost of all types of insurance carried or paid for by Landlord, accounting costs, all costs of maintaining, repairing and replacing paving, curb, sidewalks, roadways, landscaping, drainage, lighting and utility systems, the cost of maintaining and repairing the walls, roof and other portions of the Building, the cost of maintaining and repairing all heating, ventilating and air-conditioning equipment and depreciation thereof, rental charges for machinery and equipment used in maintaining and operating the Project (and, if applicable, the Shared Parking Area), salaries and compensation of personnel

connected with such operation and maintenance and deductible amounts payable under insurance policies. Landlord, in its reasonable discretion, shall from time to time determine the method of computing the operating costs, the allocation of operating costs to various types of space within the Building, and the extent of the appurtenances to the Project, and Tenant shall be bound thereby.

Tenant's failure to pay Tenant's share of operating costs in the manner herein provided shall be treated hereunder in the same manner as a default in the payment of Base Rent.

#### 8. LANDLORD'S REPAIRS.

Landlord shall at its expense maintain only the roof, foundation and the structural soundness of the exterior walls of the Building in good repair reasonable wear and tear excepted. Tenant shall reimburse Landlord upon demand, however, for any maintenance or repairs necessitated by the act or negligence of Tenant for Tenant's employees, agents, representatives or invitees, or caused by Tenant's default hereunder. The term "walls" as used herein shall not include windows, glass or plate glass or doors. Tenant shall immediately give Landlord written notice of defect or need for repairs, after which Landlord shall have reasonable opportunity to repair same or cure such defect. Landlord's liability hereunder shall be limited to the cost of such repairs or curing such defect.

#### 9. TENANT'S REPAIRS.

Tenant shall at its own cost and expense maintain all other parts of the Premises in good repair, reasonable wear and tear excepted and shall take good care of the Premises and its fixtures and suffer no waste. Tenant will keep the whole of the Premises in clean, sanitary and safe condition, and will at the expiration or earlier termination of this Lease surrender the same to Landlord, broom clean, and in the same order and condition as they were in at the commencement of this Lease, reasonable wear and tear excepted.

#### 10. ALTERATIONS.

Tenant shall not make structural additions or alterations to the Building or the Premises or install any equipment which defaces the Building interior or exterior or bolt or otherwise physically attach machinery or equipment to the floors or walls of the Premises. Except for alterations which do not violate the provisions of the proceeding sentence and the aggregate cost of which does not exceed three (3) months Base Rent during any twelve (12) month period. Tenant shall not make any alterations of, or additions to, the Premises without the prior written consent of Landlord. Tenant will not permit any mechanics', laborers' or materialmen's liens to stand against the Premises or the Project for any labor or material furnished to, or for the account of, Tenant or claimed to have been so furnished in connection with any work performed or claimed to have been performed in, or about the Premises.

At the expiration or earlier termination of this Lease, Tenant shall, if the Landlord so elects, remove all alterations and additions erected by Tenant and restore the Premises to their original condition; otherwise such improvements shall be delivered up to the Landlord with the Premises. All movable office furnishings and trade fixtures installed by Tenant may be removed by Tenant at the termination of this Lease if Tenant so elects, and shall be removed if required by Landlord. All such removals and restoration shall be accomplished in a good and workmanlike manner so as not to damage the primary structure or structural qualities of the Premises. Personal property remaining in the Premises at the expiration or earlier termination of the term of this Lease shall be deemed abandoned, and Landlord may dispose of the same as Landlord deems expedient.

#### 11. SIGNS.

Tenant shall not erect any exterior signs, advertising media or lettering without the prior written consent of Landlord. Any such items consented to by Landlord and installed by Tenant shall comply with any applicable governmental laws, ordinances, regulations and other requirements. Tenant shall remove all such signs at the termination of this Lease. Such installations and removals shall be made in such manner as to avoid injury or defacement of the Premises.

#### 12. INSPECTION.

Upon reasonable notice to Tenant, Landlord and Landlord's agents and representatives shall have the right to enter the Premises for the purpose of ascertaining the condition thereof or in order to make such repairs as may be required to be made by Landlord hereunder or as Landlord may deem necessary or for the purpose of showing the Premises and shall have the right to erect on the Premises a suitable sign indicating that the Premises are available for sale for rent. Any such entry by Landlord shall never be deemed an eviction or disturbance of Tenant's possession of the Premises, or render Landlord liable to Tenant for damages, or relieve Tenant from performance of Tenant's obligations under this Lease.

#### 13. UTILITIES.

Tenant shall pay for all heating, air conditioning, ventilation, electricity, gas, water, sewer, telephone, waste removal and other services and utilities used in the Premises commencing on the date Tenant has access thereto for the purpose of installing leasehold improvements and continuing throughout the term hereof. All utilities, except water, will be separately metered and Tenant shall

contract for the same in its own name and shall promptly and directly pay all charges for such utilities consumed in the Premises. If, in

Landlord's opinion, Tenant's use of water service is greater than the average use of water service by other Tenants in the Project, Landlord may require Tenant to install a separate meter for water and, in such an event, Tenant shall pay the cost of purchasing, installing and maintaining such a metering device. In the event that Tenant fails to install such a separate metering device within thirty (30) days of notice of Landlord's requirement that such a device be installed, Landlord may, but shall not be obligated to, install such a device and all sums and incidental costs and expenses paid by Landlord in connection with the purchase and installation of such device shall be payable by Tenant to Landlord on demand.

Landlord does not warrant that any of the utilities and service referred to in this paragraph, whether furnished by Landlord or by any other supplier of any utility or other service will be free from interruption. Interruption of service shall never be deemed an eviction or disturbance of Tenants; use and possession of the Premises or any part thereof, or render Landlord liable to Tenant from performance of Tenant's obligations under this Leases.

#### 14. ASSIGNMENT AND SUBLETTING.

Tenant shall not have the right to assign this Lease, by operation of law or otherwise, or to sublet the whole or any part of the Premises without the prior written consent of Landlord. Consent by Landlord to one or more assignment or subletting shall not operate as a waiver of Landlord's rights under this paragraph as to any subsequent assignment or subletting. Notwithstanding any permitted assignment or subletting, Tenant shall at all times remain fully responsible and liable for the payment of the rent herein and for compliance with all of its other obligations under the terms, provisions and covenants of this Lease. If Tenant is a corporation or partnership or other entity, any change in the control of Tenant shall be deemed to be an assignment which shall require Landlord's consent as set forth above. Landlord shall have the right to assign any of its rights under this Lease, and upon any such assignment, and provided that the assignee assumes all of the Landlord's obligations hereunder, Landlord shall be relieved of any and all such obligations.

#### 15. FIRE OR OTHER CASUALTY DAMAGE.

A. If the Project or any part thereof is damaged or destroyed by fire or other casualty. Landlord shall have the right to terminate this Lease, provided it gives written notice thereof to Tenant within ninety (90) days after such damage or destruction. If a portion of the Premises is damaged by fire or other casualty and this Lease is not thereby terminated. Landlord shall, at its expense, restore the Premises, exclusive of any improvements or other changes made to the Premises by Tenant, to as near the condition which existed immediately prior to such damage or destruction as reasonably possible, and rent shall abate during such period of times as the Premises are untenable in the proportion that the untenable portion of the Premises bears to the entire Premises. Landlord shall not be responsible to Tenant for damage to, or destruction of, any furniture, equipment, improvements or other changes made by Tenant in, or about the Premises regardless of the cause of the damage or destruction.

B. Landlord and Tenant each hereby release the other from any and all liability or responsibility to the other or anyone claiming through or under them by way of subrogation or otherwise for any loss or damage to property caused by fire or any of the extended coverage casualties covered by the insurance maintained hereunder, even if such fire or other casualty shall have been caused by the fault or negligence of the other party or anyone for whom such party may be responsible; provided, however, that this release shall be applicable and in force and effect only with respect to loss or damage occurring during such times as the releasor's policies shall contain a clause or endorsement to the effect that any release shall not adversely affect or impair said policies or prejudice the right of the releasor to recover thereunder. Landlord and Tenant each agree that it will require its insurance carriers to include in its policies such a clause or endorsement.

C. Landlord covenants and agrees to maintain standard fire and extended coverage insurance covering the Building in an amount not less than eighty percent (80%) of the replacement cost thereof. Tenant covenants and agrees to maintain standard fire and extended coverage insurance covering its property located in, on or about the Premises in an amount not less than eighty percent (80%) of the replacement cost thereof. Tenant agrees that said property is kept in the Premises Tenant's sole risk.

Tenant assumes full responsibility for protection the Premises from theft, robbery and pilferage, which includes keeping doors locked and other means of entry to the Premises closed and secured after normal business hours.

#### 16. LIABILITY.

Tenant agrees to indemnify and save Landlord harmless against any and all claims, demands, damages, costs and expenses, including reasonable attorney's fees for the defense thereof, arising from the conduct or management of the business conducted by Tenant in the Premises or from any breach or default on the part of Tenant in the performances of any covenant or agreement on the part of Tenant to be performed pursuant to the terms of this Lease, or from any act or negligence of Tenant, its agents, contractors, servants, employees, subleases, concessionaires, licenses or invitees, or any other person entering upon the Premises under express or implied invitation of Tenant. In case of any action or proceeding brought against Landlord by reason of any such claim upon notice from Landlord, Tenant covenants to defend such action of proceeding by counsel satisfactory to Landlord. Landlord shall not be liable and Tenant waives all claims for damage to person or property sustained by Tenant or Tenant's agents, contractors, servants, employees, subleases, concessionaires licensees or invitees resulting from the Building or the Premises or any equipment or appurtenances thereunto appertaining becoming out of repair, or resulting from any accident in or about the Premises, the Project or resulting directly or indirectly from any act or neglect of any other Tenant in the Project. This shall, apply expressly, but not exclusively, to the flooding of the Premises, and to damage caused by refrigerators, sprinkling devices air-conditioning apparatus, water, snow, frost, steam,

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excessive heat or cold, falling plaster, broken glass, sewage, gas, odors and noise, or the bursting or leaking of pipes or plumbing fixtures. Tenant, at its sole cost and expense, shall procure and maintain throughout the term hereof a policy or policies of insurance. Insuring both Landlord and Tenant against all claims, demands or actions arising out of or in connection with Tenant's use or occupancy of the Premises, or by the condition of the Premises, the limits of such policy or policies to be in an amount not less than \$1,000,000.00 combined single limits of liability, and to be written by insurance companies satisfactory to Landlord and qualified to do business in the state in which the Premises are located. Such policies or duly executed certificates of insurance shall be promptly delivered to Landlord and renewals thereof as required shall be delivered to Landlord at least ten (10) days prior to the expiration of the respective policy terms, shall contain an agreement by the insurer that the same may not be canceled or materially without at least ten (10) days' prior written notice to Landlord.

#### 17. CONDEMNATION

A. If the entire Project is taken by eminent domain, this Lease shall automatically terminate as of the date of taking. If a portion of the Project is taken by eminent domain, Landlord shall have the right to terminate this Lease by giving written notice thereof to Tenant within ninety (90) days after the date of taking. \*If a portion of the Premises is taken by eminent domain and this Lease is not thereby terminated, Landlord shall, at its expense, restore the Premises, exclusive of any improvements or other changes made to the Premises by Tenant, to as near the condition which existed immediately prior to the date of taking as reasonable possible, and rent shall abate during such period of time as the Premises are untenable in the proportion that the untenable portion of the Premises bears to the entire Premises.

B. Any compensation or award paid or payable on account of any such taking shall belong to, and be the sole property of, Landlord or the then owner or owners of the Project

#### 18. SURRENDER OF POSSESSIONS, HOLDING OVER

At the expiration or earlier termination of the term of this Lease, Tenant shall return all keys to the Premises to Landlord and shall surrender the Premises in good condition and repair except for reasonable wear and tear, any repairs specifically required herein to be performed by Landlord and loss by fire or other causes covered by Landlord's insurance. Should Tenant, or any of its successors in interest, holdover the Premises or any part thereof, after the expiration of the term of this Lease, without Landlord's written consent, such holding over shall, at the Landlord's option, constitute and be construed as a tenancy from month to month only, at a rental equal to twice the rental payable for the last month of the term of this Lease. The inclusion of the preceding sentence shall not be construed as Landlord's permission for Tenant to hold over.

#### 19. QUIET ENJOYMENT

Landlord represents and warrants that it has full right and authority to enter into this Lease and that Tenant, upon paying the rental herein set forth and performing its other covenants and agreements herein set forth, shall peaceably and quietly have, hold and enjoy the Premises for the term hereof without hindrance or molestation from Landlord, subject to the terms and provisions of this Lease.

#### 20. EVENTS OF DEFAULT

Any one or more of the following events shall constitute an event of default under this Lease:

A. If Tenant fails to pay, when due, any installment of Base Rent or Tenant's share of operating costs or any other payment required to be by Tenant paid hereunder.

B. If Tenant fails to perform or comply with any of the other terms, conditions and obligations of this Lease;

C. If a writ of execution, attachment or other process of law shall cause levy on or against the property of Tenant or a receiver or trustees shall be appointed for all or substantially all of the assets of Tenant;

D. If Tenant shall become insolvent, or shall make a transfer in fraud of creditors, shall admit in writing its inability to pay its debts as they become due, or shall commence any proceeding or file a petition under the provisions of the Federal Bankruptcy Code for liquidation, reorganization or adjustment of debts. or under any insolvency law or other statute or law providing for the modification or adjustment of the rights of creditors, or shall file an answer admitting to or not contesting the material allegations of a petition filed against it in any such proceeding, or an order for relief shall be entered by a federal Bankruptcy Court in any such proceeding or Tenant shall not, within sixty (60) days after the commencement of any such proceeding or the filing of any such petition without its consent, have the same dismissed or vacated, or shall consent to the appointment of a custodian (as that term is defined in the Federal Bankruptcy Code) for, or assignment to a custodian of, the whole or any substantial part of its properties, or shall not, within sixty (60) days after such an appointment or assignment without its consent or acquiescence, have such appointment or assignment vacated or set aside;

E. If Tenant shall vacate or abandon the Premises or the Premises shall become vacant; or

F. If Tenant shall have been notified by Landlord of a default by Tenant under this Lease more than three (3) times in any calendar year.

#### 21. REMEDIES.

Upon the occurrence of any of such events of default described in Paragraph 20 hereof, Landlord shall have the option of pursue any one or more of the following remedies without any notice or demand whatsoever:

A. Terminate this Lease, in which event Tenant shall immediately surrender the Premises to Landlord, and if Tenant fails so to do, Landlord may, without prejudice to any other remedy which it may have for possession or arrearages in rent, enter upon and take possession of the Premises and expel or removal Tenant and any other person who may be occupying the Premises or any part thereof, by force if necessary, without being liable for prosecution or any claim for damages therefor, and Tenant agrees to pay to Landlord on

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demand the amount of all loss and damage which Landlord may suffer by reason of such termination. In the event of termination of this Lease as aforesaid, Landlord may elect to recover from Tenant, as and for liquidated damages for loss of the bargain and not as a penalty, an amount equal to the difference between (1) the Base Rent, Tenant's share of operating costs and other charges reserved hereunder for the period which otherwise should have been the balance of the term hereof; and

B. Enter upon and take possession of the Premises and expel or remove Tenant and any other person who may be occupying the Premises or any part thereof, by force if necessary, without being liable for prosecution or any claim for damages therefore, all without terminating this Lease or any of Tenant's obligations hereunder. In such event, Landlord may make alterations and repairs and redecorate the Premises to the extent deemed by Landlord necessary or desirable, and may relent the Premises, or any part thereof, for the account of Tenant, to any person, firm or corporation, other than Tenant, for such rent, for such time and upon such terms as Landlord, in Landlord's sole discretion, shall determine. In so doing, Landlord shall not be required to accept any tenant offered by Tenant or to observe any instruction given by Tenant concerning such reletting. Any rent and other amounts received by Landlord upon such reletting shall be applied first to the costs and expenses of Landlord in regaining possession of the Premises, storing property removed from the Premises, making alterations or repairs, redecorating the Premises and reletting the Premises including, without limitation, brokerage and attorneys' fees and then such rent and other amounts shall be applied to the Base Rent, operating costs and other obligations of Tenant under this Lease, and Tenant agrees to pay to Landlord on demand any deficiency that may arise by reason of such reletting.

C. Enter upon the Premises, by force if necessary, without liable for prosecution or any claim for damages therefor, and do whatever Tenant is obligated to do under the terms of this Lease, and Tenant agrees to reimburse Landlord on demand for any expenses which landlord may incur in thus effecting compliance with Tenant's obligations under this Lease, with interest as provided in Paragraph 26F hereof, and Tenant further agrees that Landlord shall not be

liable for any damages resulting to Tenant from such action, whether caused by the negligence of Landlord or otherwise.

Pursuit of any of the foregoing remedies shall not preclude pursuit of any of the other remedies herein provided or any other remedies provided by law. Landlord may at any time elect to terminate this Lease as described in A above despite a prior election to exercise its remedies under B or C above. Pursuit of any remedy herein provided shall not constitute a forfeiture or waiver of any rent due to Landlord hereunder or of any damages accruing to Landlord by reason of the violation of any of the terms, provisions and covenants herein contained.

No waiver by Landlord of any violation or breach of any of the terms, provisions and covenants herein contained shall be deemed or construed to constitute a waiver of any other violation or breach of any of the terms, provisions and covenants herein contained. Landlord's acceptance of the payment of rental or other payments hereunder after the occurrence of an event of default shall not be construed as a waiver of such default unless Landlord so notifies Tenant in writing. Forbearance by Landlord to enforce one or more of the remedies herein provided upon an event of default shall not be deemed or construed to constitute a waiver of such default. If, on account of any breach or default by Tenant in Tenant's obligations under the terms and conditions of this Lease, it shall become necessary or appropriate for Landlord to employ or consult with an attorney concerning or to enforce or defend any of Landlord's rights or remedies hereunder, Tenant agrees to pay any reasonable attorneys' fees and a management fee in the amount of Three Hundred and no/100 Dollars (\$300.00). No act or thing done by the Landlord or its agents during the term hereby granted shall be deemed an acceptance of the surrender of the Premises, and no agreement to accept a surrender of the Premises shall be valid unless in writing signed by Landlord.

#### 22. LANDLORD'S RIGHT TO CURE

If Tenant defaults in the making of any payment or the doing of any act required to, make such payment or do such act, and the costs incurred by Landlord in doing so, with interest thereon as provided in paragraph 26F hereof, shall be paid by Tenant to Landlord upon demand. The making of such payment or the doing of such act by Landlord shall not operate to cure such default by Tenant or to prevent or stop Landlord from enforcing or pursuing any rights and remedies which Landlord would otherwise have.

#### 23. MORTGAGES

Tenant accepts this Lease subject and subordinate to any mortgage(s) and/or deed(s) of trust and/or ground lease(s) or other underlying leases(s) now or at any time hereafter consulting a lien or charge upon the Premises, and Tenant shall at any time hereafter on demand execute any instruments, releases or other documents which may require by any mortgagee, trustee or lessor for the purpose of subjecting and subordinating this Lease to the lien of any such mortgage, deed of trust, ground leases or other underlying lease. In the event Tenant fails to comply with any such demand within ten (10) days following the demand, Tenant shall be deemed to have appointed Landlord as Tenant's attorney-in-fact to execute any such instruments, releases or other documents. With respect to any mortgage(s) and/or deed(s) of trust and/or ground lease(s) or other underlying lease(s) now or at any time hereafter created which constitute a lien or charge upon the Premises, Landlord at its sole option shall have the right to waive the applicability of this paragraph so that this Lease would not be subject and subordinate to such mortgage(s) or deed(s) of trust or ground lease(s) or other underlying lease(s).

#### 24. NOTICES

Each provision of this instrument or of any applicable law or regulation with reference to the sending, mailing or delivery of any notice or the making of any payment by Landlord to Tenant or by Tenant to Landlord shall be deemed to be complied with when and if the following steps are taken:

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A. All rent and other payments required to be made by Tenant to Landlord hereunder shall be payable to Landlord at the address hereinbelow set forth or at such other address as Landlord may specify from time to time by written notice delivered in accordance herewith.

B. Any notice or document required or permitted to be delivered hereunder shall be deemed to be delivered, whether actually received or not, when deposited in the United States mail, postage prepaid, certified or registered mail, addressed to the parties hereto at the respective addresses set out opposite their names below, or at such other address as they have theretofore specified by written notice delivered in accordance herewith:

Landlord:

7725 Washington Avenue Corp.

7808 Creekridge Circle, #200

Minneapolis, MN 55439

Tenant:

Rimage Systems, Inc.

7725 Washington Avenue South

Edina, MN 55439

C. Any notice or document required or permitted to be delivered hereunder by Landlord to Tenant also shall be deemed to be delivered if an when delivered personally to Tenant (or to an agent of Tenant if Tenant is not an individual) at the Premises.

#### 25. RULES AND REGULATIONS

Tenant shall use the Premises and the common areas of the project in accordance with such rules and regulations as may from time to time be made by Landlord for the general safety, convenience and comfort of the owners, occupants and tenants of the project, and shall cause Tenant's employees, agents, representatives and invitees to abide by such rules and regulations. The rules and regulations now in effect are attached hereto as Exhibit D and are hereby made a part hereof, and Tenant hereby acknowledges receipt of the same.

#### 26. MISCELLANEOUS

A. Words of any gender used in this Lease shall be held and construed to include any other gender, and words in the singular number shall be held to include the plural, unless the context otherwise requires. The headings of the paragraphs of this Lease are for convenience only and do not limit or define the contents of said paragraphs.

B. The terms, provisions and covenants and conditions contained in this Lease shall apply to, inure to the benefit of, and be binding upon, the parties hereto and upon their respective heirs, legal representatives, successors and permitted assigns, except as otherwise herein expressly provided.

C. Tenant agrees, within ten (10) days after request of Landlord, or Landlord's designee, including without limitation, the present or any future holder of a mortgage(s) and/or deed(s) of trust and/or ground lease(s) and/or other underlying lease(s) on the Premises, or any prospective purchaser of the Premises, an estoppel certificate stating that this Lease is in full force and effect, the date to which rent and other charges have been paid, the unexpired term of this Lease, whether or not Landlord is in default hereunder, and the nature of any such default, and such other matters pertaining to this Lease as may be reasonably requested by Landlord.

D. If any term, provision or covenant of this Lease or the application thereof to any person or circumstances shall, to any extent, be held to be invalid or unenforceable, the remainder thereof and the application of such term, provision or covenant to other persons or circumstances shall not be affected thereby, and this Lease and all the terms, provisions and covenants hereof shall, in all other respects, continue to be valid and enforceable and to be complied with to the full extent permitted by law.

E. This Lease may not be altered, changed or amended except by an instrument in writing signed by Landlord and Tenant.

F. Base Rent, Tenant's share of operating costs and all other payments required of Tenant pursuant to the provisions of this Lease, shall be deemed rent due hereunder whether or not so designated. All such rent shall bear interest from the due date thereof (or from the date of advancement of funds by Landlord if the payment by Tenant is required by virtue of Landlord's advancement of funds to cure Tenant's default hereunder) until paid at a rate equal to the lesser of (i) the highest rate permitted by law; and (ii) two (2) percentage points in excess of the reference rate from time to time announced by First National Bank of Minneapolis.

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#### 27. ACCEPTANCE BY LANDLORD.

This Lease shall not be binding upon Landlord until approved in writing by, and signed by an officer of, Landlord, but this Lease may not be revoked or terminated by Tenant for a period of ten (10) days from the date hereof.

EXECUTED the 1st day of September, 1998.

LANDLORD:

CORPORATE OR BUSINESS TENANT:

7725 Washington Avenue Corp.

Rimage Systems, Inc.

By \_\_\_\_\_  
An agent but not an Officer

Approved: \_\_\_\_\_

By /s/ James Reissner

By /s/ Bernard P. Aldrich

Its Vice President

Title President and CEO

EXHIBIT D

MONTHLY RENT. This lease provides for base rent and base rent escalators as follows:

October 1, 1998	Base rent will be \$6.75 per square foot or
	Annually     \$290,250.00
	Monthly     \$ 24,187.50
October 1, 1999	Base rent will be \$6.95 per square foot or
	Annually     \$298,850.00
	Monthly     \$ 24,904.17
October 1, 2000	Base rent will be \$7.16 per square foot or
	Annually     \$307,880.00
	Monthly     \$ 25,656.67
October 1, 2001	Base rent will be \$7.37 per square foot or
	Annually     \$316,910.00
	Monthly     \$ 26,409.17
October 1, 2002	Base rent will be \$7.59 per square foot or
	Annually     \$326,370.00
	Monthly     \$ 27,197.50

The five (5) year renewal option, if exercised, will be as follows:

January 1, 2004	Base rent will be \$7.82 per square foot or
	Annually     \$336,260.00
	Monthly     \$ 28,021.67
January 1, 2005	Base rent will be \$8.05 per square foot or
	Annually     \$346,150.00
	Monthly     \$ 28,845.83
January 1, 2006	Base rent will be \$8.29 per square foot or
	Annually     \$356,470.00
	Monthly     \$ 29,705.83
January 1, 2007	Base rent will be \$8.54 per square foot or
	Annually     \$367,220.00
	Monthly     \$ 30,601.67
January 1, 2008	Base rent will be \$8.80 per square foot or
	Annually     \$378,400.00
	Monthly     \$ 31,533.33

## LEASE

Venture III Properties (Owner/Landlord)	September 1, 1998 (Lease Date)	\$ 10,428.00 (Monthly Base Rent)
Rimage Corporation (Tenant)	28,440 SF (Unit(s))	\$ None Paid (Security Deposit)
Penn Avenue Building (Project)	5 years (60 mos) (Term)	\$ _____ Paid (First Month's Rent)
9701 Penn Avenue South (Address)	September 1, 1998 (Beginning)	\$ _____ Paid (Improvements)
Bloomington, MN 55431 (City, State, Zip)	September 30, 2003 (Ending)	\$ _____ Paid (Receipt By)

THIS LEASE is made and entered into this 1st day of September, 1998 between Venture III Properties with its principal place of business at 7808 Creekridge Circle, Suite 200, Minneapolis, MN 55439 (herein called "Landlord"), and Rimage Corporation a corporation organized under the laws of the State of Minnesota with its principal business at 7725 Washington Avenue South, Edina, MN 55439 (herein called "Tenant", whether one or more).

## WITNESSETH:

## 1. PREMISES.

In consideration of the obligation of Tenant to pay rent as herein provided, and in consideration of the other terms, provisions and covenants hereof, Landlord hereby leases to Tenant, and Tenant hereby takes from Landlord, certain Premises (herein called the "Premises") situated in the County of Hennepin, State of Minnesota, consisting of approximately 28,440 square feet of gross rentable area outlined in red on the floor plan attached hereto Exhibit A and made a part hereof in the building commonly known as Penn Avenue Building (herein called the "Building") located at 9701 Penn Avenue South, Bloomington, MN 55431 which building is situated upon the real property described on Exhibit B attached hereto and hereby made a part hereof (the Building and said real property are herein called the "Project"), together with the right to use in common with Landlord and other Tenants in the Project, and their employees, agents, representatives and invitees, any common areas and facilities of the Project and together with the right to use any parking area (herein called the "Shared Parking area") located outside of the Project which is designated by Landlord, by written notice from Landlord to Tenant, as a parking area which Tenant may use in common with other parties designated by Landlord.

## 2. TERM.

This Lease shall be for a term of five (5) years and 0 months, commencing on September 1, 1998, and expiring on September 30, 2003.

## 3. WORK LETTER.

Landlord, at its sole cost and expense, shall construct any leasehold improvements required to be by Landlord constructed pursuant to the Work Letter (herein called the "Work Letter") attached hereto as Exhibit C and made a part hereof.

## 4. RENT.

Tenant shall pay Landlord, without deduction or setoff, an annual minimum rental (herein sometimes called "Base Rent of:

One Hundred Twenty Five Thousand One Hundred Thirty Six and no/100 Dollars  
(\$125,136.00)

payable, in advance, without demand, on or before the first day of each and every month during the term hereof; provided, however, that if the term hereof shall commence upon a day other than the first day of a calendar month or expire upon a day other than the last day of the calendar month. Base Rent for the partial calendar month shall be prorated on a per diem basis and shall be paid

by Tenant on the commencement date of the term hereof (in the case of an initial partial month) or on the first day of the month in which the term hereof expires (in the case of a terminal partial month).

#### 5. SECURITY DEPOSIT.

Tenant agrees to deposit with Landlord on the date hereof the sum of

None

which sum shall be held by Landlord, without obligation for interest, as security for the performance of Tenant's covenants and obligations under this Lease, it being expressly understood and agreed that such deposit is not an advance rental deposit or a measure of Landlord's damages in case of Tenant's default. Upon the occurrence of any event of default by Tenant, Landlord may, from time to time without prejudice to any other remedy provided herein or provided by law, use such fund to the extent necessary to make good any areas of rent and any other damage, injury, expense or liability caused by such event of default, and Tenant shall pay to Landlord on demand the amount so applied in order to restore the security deposit to its original amount. If Tenant is not then in default hereunder, any remaining balance of such deposit shall be returned by Landlord to Tenant upon termination of this Lease.

#### 6. USE

Subject to the following provisions of this Paragraph 6, the Premises may be used for any lawful purpose. Tenant shall comply with all governmental laws, ordinances and regulations applicable to the use of the Premises and shall promptly comply with all governmental orders and directives for the correction, prevention and abatement of nuisances in, upon or connected with the Premises, all at Tenant's sole expenses. Tenant shall not receive, store or otherwise handle any product, material or merchandise which is explosive or highly inflammable and will not permit the Premises to be used for any purpose which would render the insurance thereon void or the insurance risk more hazardous, or increase the premiums therefore, and in the event of any such increase by reason of any activity conducted by Tenant in, on or about the Premises, Tenant shall be liable for such increase and shall reimburse Landlord therefor. Tenant shall not store any material or merchandise outside the Premises.

#### 7. OPERATING COSTS.

Prior to the commencement of the term of this Lease and prior to March 1 of each calendar year thereafter, or as soon thereafter as practicable. Landlord shall furnish Tenant with a written statement of the estimated operating costs per square foot of gross rentable area of the Building for such calendar year. During the remainder of such calendar year, Tenant shall pay Landlord at the times that the monthly Base Rent is due and payable hereunder an amount equal to one-twelfth (1/12) of the product of the number of gross square feet in the Premises times such estimate. If Tenant's monthly payment of estimated operating costs is greater than the monthly amount of operating expenses Tenant paid for the then elapsed calendar months of such calendar year, then, within ten (10) days after such written estimate is given. Tenant shall also pay to a Landlord the deficiency for said elapsed calendar months. After the expiration of each calendar year falling in whole or in part within the term hereof. Landlord shall furnish Tenant with a written statement of the actual operating costs of the Project (and, if applicable, the Shared Parking Area) for the preceding calendar year, and if such actual operating costs for such preceding calendar year are more or less than the estimate, an appropriate adjustment shall be made within ten (10) days after such written statement is furnished.

For the purposes hereof, operating costs shall be deemed to mean all taxes (both general and special and whether now or hereafter enacted), assessments or governmental charges levied or assessed against the Project (and, if applicable, the Shared Parking Area) or any part thereof, and all costs which, for federal tax purposes, may be expensed rather than capitalized, and which Landlord will or does incur, pay or become obligated to pay in owning, maintaining, operating and leasing the Project (and, if applicable the Shared Parking Area) and appurtenances thereto, exclusive of interest and depreciation, Without limiting the generality of the foregoing operating costs shall include personal property taxes, fees or permits or licenses, a management fee or fees not to exceed five percent (5%) of the Base Rent, landscaping and gardening cleaning, painting, decorating, paving, lighting, security guards, leasing and maintenance of music and intercom systems. If any, removal of snow, trash, garbage and other refuse, heating, ventilating and air-

conditioning, costs and expenses in connection with meeting federal state, or local environmental energy standards, fire protection, water and sewage and other utility charges not separately metered and charged to particular Tenants, the cost of all types of insurance carried or paid for by Landlord, accounting costs, all costs of maintaining, repairing and replacing paving, curb, sidewalks, roadways, landscaping, drainage, lighting and utility systems, the cost of maintaining and repairing the walls, roof and other portions of the Building, the cost of maintaining and repairing all heating, ventilating and air-conditioning equipment and depreciation thereof, rental changes for

machinery and equipment used in maintaining and operating the Project (and, if applicable, the Shared Parking Area), salaries and compensation of personnel connected with such operation and maintenance and deductible amounts payable under insurance policies. Landlord, in its reasonable discretion, shall from time to time determine the method of computing the operating costs, the allocation of operating costs to various types of space within the Building, and the extent of the appurtenances to the Project, and Tenant shall be bound thereby.

Tenant's failure to pay Tenant's share of operating costs in the manner herein provided shall be treated hereunder in the same manner as a default in the payment of Base Rent.

#### 8. LANDLORD'S REPAIRS.

Landlord shall at its expense maintain only the roof, foundation and the structural soundness of the exterior walls of the Building in good repair reasonable wear and tear excepted. Tenant shall reimburse Landlord upon demand, however, for any maintenance or repairs necessitated by the act or negligence of Tenant for Tenant's employees, agents, representatives or invitees, or caused by Tenant's default hereunder. The term "walls" as used herein shall not include windows, glass or plate glass or doors. Tenant shall immediately give Landlord written notice of defect or need for repairs, after which Landlord shall have reasonable opportunity to repair same or cure such defect. Landlord's liability hereunder shall be limited to the cost of such repairs or curing such defect.

#### 9. TENANT'S REPAIRS.

Tenant shall at its own cost and expense maintain all other parts of the Premises in good repair, reasonable wear and tear excepted and shall take good care of the Premises and its fixtures and suffer no waste. Tenant will keep the whole of the Premises in clean, sanitary and safe condition, and will at the expiration or earlier termination of this Lease surrender the same to Landlord, broom clean, and in the same order and condition as they were in at the commencement of this Lease, reasonable wear and tear excepted.

#### 10. ALTERATIONS.

Tenant shall not make structural additions or alterations to the Building or the Premises or install any equipment which defaces the Building interior or exterior or bolt or otherwise physically attach machinery or equipment to the floors or walls of the Premises. Except for alterations which do not violate the provisions of the proceeding sentence and the aggregate cost of which does not exceed three (3) months Base Rent during any twelve (12) month period. Tenant shall not make any alterations of, or additions to, the Premises without the prior written consent of Landlord. Tenant will not permit any mechanics', laborers' or materialmen's liens to stand against the Premises or the Project for any labor or material furnished to, or for the account of, Tenant or claimed to have been so furnished in connection with any work performed or claimed to have been performed in, or about the Premises.

At the expiration or earlier termination of this Lease, Tenant shall, if the Landlord so elects, remove all alterations and additions erected by Tenant and restore the Premises to their original condition; otherwise such improvements shall be delivered up to the Landlord with the Premises. All movable office furnishings and trade fixtures installed by Tenant may be removed by Tenant at the termination of this Lease if Tenant so elects, and shall be removed if required by Landlord. All such removals and restoration shall be accomplished in a good and workmanlike manner so as not to damage the primary structure or structural qualities of the Premises. Personal property remaining in the Premises at the expiration or earlier termination of the term of this Lease shall be deemed abandoned, and Landlord may dispose of the same as Landlord deems expedient.

#### 11. SIGNS.

Tenant shall not erect any exterior signs, advertising media or lettering without the prior written consent of Landlord. Any such items consented to by Landlord and installed by Tenant shall comply with any applicable governmental laws, ordinances, regulations and other requirements. Tenant shall remove all such signs at the termination of this Lease. Such installations and removals shall be made in such manner as to avoid injury or defacement of the Premises.

#### 12. INSPECTION.

Upon reasonable notice to Tenant, Landlord and Landlord's agents and representatives shall have the right to enter the Premises for the purpose of ascertaining the condition thereof or in order to make such repairs as may be required to be made by Landlord hereunder or as Landlord may deem necessary or for the purpose of showing the Premises and shall have the right to erect on the Premises a suitable sign indicating that the Premises are available for sale for rent. Any such entry by Landlord shall never be deemed an eviction or disturbance of Tenant's possession of the Premises, or render Landlord liable to Tenant for damages, or relieve Tenant from performance of Tenant's obligations under this Lease.

#### 13. UTILITIES.

Tenant shall pay for all heating, air conditioning, ventilation, electricity, gas, water, sewer, telephone, waste removal and other services and utilities used in the Premises commencing on the date Tenant has access thereto for the

purpose of installing leasehold improvements and continuing throughout the term hereof. All utilities, except water, will be separately metered and Tenant shall contract for the same in its own name and shall promptly and directly pay all charges for such utilities consumed in the Premises. If, in

Landlord's opinion, Tenant's use of water service is greater than the average use of water service by other Tenants in the Project, Landlord may require Tenant to install a separate meter for water and, in such an event, Tenant shall pay the cost of purchasing, installing and maintaining such a metering device. In the event that Tenant fails to install such a separate metering device within thirty (30) days of notice of Landlord's requirement that such a device be installed, Landlord may, but shall not be obligated to, install such a device and all sums and incidental costs and expenses paid by Landlord in connection with the purchase and installation of such device shall be payable by Tenant to Landlord on demand.

Landlord does not warrant that any of the utilities and service referred to in this paragraph, whether furnished by Landlord or by Landlord or by any other supplier of any utility or other service will be free from interruption. Interruption of service shall never be deemed an eviction or disturbance of Tenants; use and possession of the Premises or any part thereof, or render Landlord liable to Tenant from performance of Tenant's obligations under this Leases.

#### 14. ASSIGNMENT AND SUBLETTING.

Tenant shall not have the right to assign this Lease, by operation of law or otherwise, or to sublet the whole or any part of the Premises without the prior written consent of Landlord. Consent by Landlord to one or more assignment or subletting shall not operate as a waiver of Landlord's rights under this paragraph as to any subsequent assignment or subletting. Notwithstanding any permitted assignment or subletting, Tenant shall at all times remain fully responsible and liable for the payment of the rent herein and for compliance with all of its other obligations under the terms, provisions and covenants of this Lease. If Tenant is a corporation or partnership or other entity, any change in the control of Tenant shall be deemed to be an assignment which shall require Landlord's consent as set forth above. Landlord shall have the right to assign any of its rights under this Lease, and upon any such assignment, and provided that the assignee assumes all of the Landlord's obligations hereunder, Landlord shall be relieved of any and all such obligations.

#### 15. FIRE OR OTHER CASUALTY DAMAGE.

A. If the Project or any part thereof is damaged or destroyed by fire or other casualty. Landlord shall have the right to terminate this Lease, provided it gives written notice thereof to Tenant within ninety (90) days after such damage or destruction. If a portion of the Premises is damaged by fire or other casualty and this Lease is not thereby terminated. Landlord shall, at its expense, restore the Premises, exclusive of any improvements or other changes made to the Premises by Tenant, to as near the condition which existed immediately prior to such damage or destruction as reasonably possible, and rent shall abate during such period of times as the Premises are untenable in the proportion that the untenable portion of the Premises bears to the entire Premises. Landlord shall not be responsible to Tenant for damage to, or destruction of, any furniture, equipment, improvements or other changes made by Tenant in, or about the Premises regardless of the cause of the damage or destruction.

B. Landlord and Tenant each hereby release the other from any and all liability or responsibility to the other or anyone claiming through or under them by way of subrogation or otherwise for any loss or damage to property caused by fire or any of the extended coverage casualties covered by the insurance maintained hereunder, even if such fire or other casualty shall have been caused by the fault or negligence of the other party or anyone for whom such party may be responsible; provided, however, that this release shall be applicable and in force and effect only with respect to loss or damage occurring during such times as the releasor's policies shall contain a clause or endorsement to the effect that any release shall not adversely affect or impair said policies or prejudice the right of the releasor to recover thereunder. Landlord and Tenant each agree that it will require its insurance carriers to include in its policies such a clause or endorsement.

C. Landlord covenants and agrees to maintain standard fire and extended coverage insurance covering the Building in an amount not less than eighty percent (80%) of the replacement cost thereof. Tenant covenants and agrees to maintain standard fire and extended coverage insurance covering its property located in, on or about the Premises in an amount not less than eighty percent (80%) of the replacement cost thereof. Tenant agrees that said property is kept in the Premises Tenant's sole risk.

Tenant assumes full responsibility for protection the Premises from theft, robbery and pilferage, which includes keeping doors locked and other means of entry to the Premises closed and secured after normal business hours.

#### 16. LIABILITY.

Tenant agrees to indemnify and save Landlord harmless against any and all claims, demands, damages, costs and expenses, including reasonable attorney's fees for the defense thereof, arising from the conduct or management of the business conducted by Tenant in the Premises or from any breach or default on the part of Tenant in the performances of any covenant or agreement on the part of Tenant to be performed pursuant to the terms of this Lease, or from any act or negligence of Tenant, its agents, contractors, servants, employees, subleases, concessionaires, licenses or invitees, or any other person entering upon the Premises under express or implied invitation of Tenant. In case of any action or proceeding brought against Landlord by reason of any such claim upon notice from Landlord, Tenant covenants to defend such action of proceeding by counsel satisfactory to Landlord. Landlord shall not be liable and Tenant waives all claims for damage to person or property sustained by Tenant or Tenant's agents, contractors, servants, employees, subleases, concessionaires licensees or invitees resulting from the Building or the Premises or any equipment or appurtenances thereunto appertaining becoming out of repair, or resulting from any accident in or about the Premises, the Project or resulting directly or indirectly from any act or neglect of any other Tenant in the Project. This shall, apply expressly, but not exclusively, to the flooding of the Premises, and to damage caused by refrigerators, sprinkling devices air-conditioning apparatus, water, snow, frost, steam,

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excessive heat or cold, falling plaster, broken glass, sewage, gas, odors and noise, or the bursting or leaking of pipes or plumbing fixtures. Tenant, at its sole cost and expense, shall procure and maintain throughout the term hereof a policy or policies of insurance. Insuring both Landlord and Tenant against all claims, demands or actions arising out of or in connection with Tenant's use or occupancy of the Premises, or by the condition of the Premises, the limits of such policy or policies to be in an amount not less than \$1,000,000.00 combined single limits of liability, and to be written by insurance companies satisfactory to Landlord and qualified to do business in the state in which the Premises are located. Such policies or duly executed certificates of insurance shall be promptly delivered to Landlord and renewals thereof as required shall be delivered to Landlord at least ten (10) days prior to the expiration of the respective policy terms, shall contain an agreement by the insurer that the same may not be canceled or materially without at least ten (10) days' prior written notice to Landlord.

#### 17. CONDEMNATION

A. If the entire Project is taken by eminent domain, this Lease shall automatically terminate as of the date of taking. If a portion of the Project is taken by eminent domain, Landlord shall have the right to terminate this Lease by giving written notice thereof to Tenant within ninety (90) days after the date of taking. \*If a portion of the Premises is taken by eminent domain and this Lease is not thereby terminated, Landlord shall, at its expense, restore the Premises, exclusive of any improvements or other changes made to the Premises by Tenant, to as near the condition which existed immediately prior to the date of taking as reasonable possible, and rent shall abate during such period of time as the Premises are untenable in the proportion that the untenable portion of the Premises bears to the entire Premises.

B. Any compensation or award paid or payable on account of any such taking shall belong to, and be the sole property of, Landlord or the then owner or owners of the Project

#### 18. SURRENDER OF POSSESSIONS, HOLDING OVER

At the expiration or earlier termination of the term of this Lease, Tenant shall return all keys to the Premises to Landlord and shall surrender the Premises in good condition and repair except for reasonable wear and tear, any repairs specifically required herein to be performed by Landlord and loss by fire or other causes covered by Landlord's insurance. Should Tenant, or any of its successors in interest, holdover the Premises or any part thereof, after the expiration of the term of this Lease, without Landlord's written consent, such holding over shall, at the Landlord's option, constitute and be construed as a tenancy from month to month only, at a rental equal to twice the rental payable for the last month of the term of this Lease. The inclusion of the preceding sentence shall not be construed as Landlord's permission for Tenant to hold over.

#### 19. QUIET ENJOYMENT

Landlord represents and warrants that it has full right and authority to enter into this Lease and that Tenant, upon paying the rental herein set forth and performing its other covenants and agreements herein set forth, shall peaceably and quietly have, hold and enjoy the Premises for the term hereof without hindrance or molestation from Landlord, subject to the terms and provisions of this Lease.

#### 20. EVENTS OF DEFAULT

Any one or more of the following events shall constitute an event of default

under this Lease:

- A. If Tenant fails to pay, when due, any installment of Base Rent or Tenant's share of operating costs or any other payment required to be by Tenant paid hereunder.
- B. If Tenant fails to perform or comply with any of the other terms, conditions and obligations of this Lease;
- C. If a writ of execution, attachment or other process of law shall cause levy on or against the property of Tenant or a receiver or trustees shall be appointed for all or substantially all of the assets of Tenant;
- D. If Tenant shall become insolvent, or shall make a transfer in fraud of creditors, shall admit in writing its inability to pay its debts as they become due, or shall commence any proceeding or file a petition under the provisions of the Federal Bankruptcy Code for liquidation, reorganization or adjustment of debts. or under any insolvency law or other statute or law providing for the modification or adjustment of the rights of creditors, or shall file an answer admitting to or not contesting the material allegations of a petition filed against it in any such proceeding, or an order for relief shall be entered by a federal Bankruptcy Court in any such proceeding or Tenant shall not, within sixty (60) days after the commencement of any such proceeding or the filing of any such petition without its consent, have the same dismissed or vacated, or shall consent to the appointment of a custodian (as that term is defined in the Federal Bankruptcy Code) for, or assignment to a custodian of, the whole or any substantial part of its properties, or shall not, within sixty (60) days after such an appointment or assignment without its consent or acquiescence, have such appointment or assignment vacated or set aside;
- E. If Tenant shall vacate or abandon the Premises or the Premises shall become vacant; or
- F. If Tenant shall have been notified by Landlord of a default by Tenant under this Lease more than three (3) times in any calendar year.

#### 21. REMEDIES.

Upon the occurrence of any of such events of default described in Paragraph 20 hereof, Landlord shall have the option of pursue any one or more of the following remedies without any notice or demand whatsoever:

- A. Terminate this Lease, in which event Tenant shall immediately surrender the Premises to Landlord, and if Tenant fails so to do, Landlord may, without prejudice to any other remedy which it may have for possession or arrearages in rent, enter upon and take possession of the Premises and expel or removal Tenant and any other person who may be occupying the Premises or any part thereof, by force if necessary, without being liable for prosecution or any claim for damages therefor, and Tenant agrees to pay to Landlord on

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demand the amount of all loss and damage which Landlord may suffer by reason of such termination. In the event of termination of this Lease as aforesaid, Landlord may elect to recover from Tenant, as and for liquidated damages for loss of the bargain and not as a penalty, an amount equal to the difference between (1) the Base Rent, Tenant's share of operating costs and other charges reserved hereunder for the period which otherwise should have been the balance of the term hereof; and

- B. Enter upon and take possession of the Premises and expel or remove Tenant and any other person who may be occupying the Premises or any part thereof, by force if necessary, without being liable for prosecution or any claim for damages therefore, all without terminating this Lease or any of Tenant's obligations hereunder. In such event, Landlord may make alterations and repairs and redecorate the Premises to the extent deemed by Landlord necessary or desirable, and may relent the Premises, or any part thereof, for the account of Tenant, to any person, firm or corporation, other than Tenant, for such rent, for such time and upon such terms as Landlord, in Landlord's sole discretion, shall determine. In so doing, Landlord shall not be required to accept any tenant offered by Tenant or to observe any instruction given by Tenant concerning such reletting. Any rent and other amounts received by Landlord upon such reletting shall be applied first to the costs and expenses of Landlord in regaining possession of the Premises, storing property removed from the Premises, making alterations or repairs, redecorating the Premises and reletting the Premises including, without limitation, brokerage and attorneys' fees and then such rent and other amounts shall be applied to the Base Rent, operating costs and other obligations of Tenant under this Lease, and Tenant agrees to pay to Landlord on demand any deficiency that may arise by reason of such reletting.

- C. Enter upon the Premises, by force if necessary, without liable for prosecution or any claim for damages therefor, and do whatever Tenant is obligated to do under the terms of this Lease, and Tenant agrees to reimburse Landlord on demand for any expenses which landlord may incur in thus effecting compliance with Tenant's obligations under this Lease, with interest as provided

in Paragraph 26F hereof, and Tenant further agrees that Landlord shall not be liable for any damages resulting to Tenant from such action, whether caused by the negligence of Landlord or otherwise.

Pursuit of any of the foregoing remedies shall not preclude pursuit of any of the other remedies herein provided or any other remedies provided by law. Landlord may at any time elect to terminate this Lease as described in A above despite a prior election to exercise its remedies under B or C above. Pursuit of any remedy herein provided shall not constitute a forfeiture or waiver of any rent due to Landlord hereunder or of any damages accruing to Landlord by reason of the violation of any of the terms, provisions and covenants herein contained. No waiver by Landlord of any violation or breach of any of the terms, provisions and covenants herein contained shall be deemed or construed to constitute a waiver of any other violation or breach of any of the terms, provisions and covenants herein contained. Landlord's acceptance of the payment of rental or other payments hereunder after the occurrence of an event of default shall not be construed as a waiver of such default unless Landlord so notifies Tenant in writing. Forbearance by Landlord to enforce one or more of the remedies herein provided upon an event of default shall not be deemed or construed to constitute a waiver of such default. If, on account of any breach or default by Tenant in Tenant's obligations under the terms and conditions of this Lease, it shall become necessary or appropriate for Landlord to employ or consult with an attorney concerning or to enforce or defend any of Landlord's rights or remedies hereunder, Tenant agrees to pay any reasonable attorneys' fees and a management fee in the amount of Three Hundred and no/100 Dollars (\$300.00). No act or thing done by the Landlord or its agents during the term hereby granted shall be deemed an acceptance of the surrender of the Premises, and no agreement to accept a surrender of the Premises shall be valid unless in writing signed by Landlord.

#### 22. LANDLORD'S RIGHT TO CURE

If Tenant defaults in the making of any payment or the doing of any act required to, make such payment or do such act, and the costs incurred by Landlord in doing so, with interest thereon as provided in paragraph 26F hereof, shall be paid by Tenant to Landlord upon demand. The making of such payment or the doing of such act by Landlord shall not operate to cure such default by Tenant or to prevent or stop Landlord from enforcing or pursuing any rights and remedies which Landlord would otherwise have.

#### 23. MORTGAGES

Tenant accepts this Lease subject and subordinate to any mortgage(s) and/or deed(s) of trust and/or ground lease(s) or other underlying leases(s) now or at any time hereafter consulting a lien or charge upon the Premises, and Tenant shall at any time hereafter on demand execute any instruments, releases or other documents which may require by any mortgagee, trustee or lessor for the purpose of subjecting and subordinating this Lease to the lien of any such mortgage, deed of trust, ground leases or other underlying lease. In the event Tenant fails to comply with any such demand within ten (10) days following the demand, Tenant shall be deemed to have appointed Landlord as Tenant's attorney-in-fact to execute any such instruments, releases or other documents. With respect to any mortgage(s) and/or deed(s) of trust and/or ground lease(s) or other underlying lease(s) now or at any time hereafter created which constitute a lien or charge upon the Premises, Landlord at its sole option shall have the right to waive the applicability of this paragraph so that this Lease would not be subject and subordinate to such mortgage(s) or deed(s) of trust or ground lease(s) or other underlying lease(s).

#### 24. NOTICES

Each provision of this instrument or of any applicable law or regulation with reference to the sending, mailing or delivery of any notice or the making of any payment by Landlord to Tenant or by Tenant to Landlord shall be deemed to be complied with when and if the following steps are taken:

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A. All rent and other payments required to be made by Tenant to Landlord hereunder shall be payable to Landlord at the address hereinbelow set forth or at such other address as Landlord may specify from time to time by written notice delivered in accordance herewith.

B. Any notice or document required or permitted to be delivered hereunder shall be deemed to be delivered, whether actually received or not, when deposited in the United States mail, postage prepaid, certified or registered mail, addressed to the parties hereto at the respective addresses set out opposite their names below, or at such other address as they have theretofore specified by written notice delivered in accordance herewith:

Landlord:

7725 Washington Avenue Corp.

7808 Creekridge Circle, #200

Minneapolis, MN 55439

Tenant:

Rimage Corporation

7725 Washington Avenue South

Edina, MN 55439

C. Any notice or document required or permitted to be delivered hereunder by Landlord to Tenant also shall be deemed to be delivered if an when delivered personally to Tenant (or to an agent of Tenant if Tenant is not an individual) at the Premises.

25. RULES AND REGULATIONS

Tenant shall use the Premises and the common areas of the project in accordance with such rules and regulations as may from time to time be made by Landlord for the general safety, convenience and comfort of the owners, occupants and tenants of the project, and shall cause Tenant's employees, agents, representatives and invitees to abide by such rules and regulations. The rules and regulations now in effect are attached hereto as Exhibit D and are hereby made a part hereof, and Tenant hereby acknowledges receipt of the same.

26. MISCELLANEOUS

A. Words of any gender used in this Lease shall be held and construed to include any other gender, and words in the singular number shall be held to include the plural, unless the context otherwise requires. The headings of the paragraphs of this Lease are for convenience only and do not limit or define the contents of said paragraphs.

B. The terms, provisions and covenants and conditions contained in this Lease shall apply to, inure to the benefit of, and be binding upon, the parties hereto and upon their respective heirs, legal representatives, successors and permitted assigns, except as otherwise herein expressly provided.

C. Tenant agrees, within ten (10) days after request of Landlord, or Landlord's designee, including without limitation, the present or any future holder of a mortgage(s) and/or deed(s) of trust and/or ground lease(s) and/or other underlying lease(s) on the Premises, or any prospective purchaser of the Premises, an estoppel certificate stating that this Lease is in full force and effect, the date to which rent and other charges have been paid, the unexpired term of this Lease, whether or not Landlord is in default hereunder, and the nature of any such default, and such other matters pertaining to this Lease as may be reasonably requested by Landlord.

D. If any term, provision or covenant of this Lease or the application thereof to any person or circumstances shall, to any extent, be held to be invalid or unenforceable, the remainder thereof and the application of such term, provision or covenant to other persons or circumstances shall not be affected thereby, and this Lease and all the terms, provisions and covenants hereof shall, in all other respects, continue to be valid and enforceable and to be complied with to the full extent permitted by law.

E. This Lease may not be altered, changed or amended except by an instrument in writing signed by Landlord and Tenant.

F. Base Rent, Tenant's share of operating costs and all other payments required of Tenant pursuant to the provisions of this Lease, shall be deemed rent due hereunder whether or not so designated. All such rent shall bear interest from the due date thereof (or from the date of advancement of funds by Landlord if the payment by Tenant is required by virtue of Landlord's advancement of funds to cure Tenant's default hereunder) until paid at a rate equal to the lesser of (i) the highest rate permitted by law; and (ii) two (2) percentage points in excess of the reference rate from time to time announced by First National Bank of Minneapolis.

27. ACCEPTANCE BY LANDLORD.

This Lease shall not be binding upon Landlord until approved in writing by, and signed by an officer of, Landlord, but this Lease may not be revoked or terminated by Tenant for a period of ten (10) days from the date hereof.

EXECUTED the 1st day of September, 1998.

LANDLORD:

Venture III Properties

By \_\_\_\_\_  
An agent but not an Officer

CORPORATE OR BUSINESS TENANT:

Rimage Systems, Inc.

By /s/ James Reissner

Its President

By /s/ Bernard P. Aldrich

Title President and CEO

Dated this 1st day of September, 1998.

Dated this 1st day of September, 1998.



RIMAGE CORPORATION AND SUBSIDIARIES  
COMPUTATION OF NET EARNINGS PER SHARE OF COMMON STOCK

Basic net earnings per common share is determined by dividing net earnings by the weighted average number of shares of common stock outstanding, unless the result is anti-dilutive. Diluted net earnings per common share is determined by dividing net earnings by the weighted average number of shares of common stock and common share equivalents outstanding, unless the result is anti-dilutive. The following is a summary of the weighted average common shares outstanding and common share equivalents:

	Three months ended September 30,		Nine months ended September 30,	
	1998	1997	1998	1997
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Shares outstanding at beginning of period	3,159,871	3,084,500	3,091,302	3,084,500
Common stock issued in stock option exercise	77,128	5,335	145,697	5,335
Shares outstanding at end of period	3,236,999	3,089,835	3,236,999	3,089,835
Weighted average shares of common stock outstanding	3,218,632	3,085,701	3,151,921	3,084,905
Common stock equivalents	889,797	764,599	889,797	764,599
Weighted average shares of common stock equivalents	512,643	198,024	462,221	139,222
Weighted average shares of common stock and stock equivalents	3,731,275	3,283,725	3,614,142	3,224,127
Net earnings	\$1,672,724	\$ 526,435	\$3,723,734	\$ 947,515
Basic net earnings per share	\$ 0.52	\$ 0.17	\$ 1.18	\$ 0.31
Diluted net earnings per share	\$ 0.45	\$ 0.16	\$ 1.03	\$ 0.29

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