SCHACHT VALUE INVESTORS, LLC

July 19, 2011

Rimage Corporation (RIMG) – A Call to Action

Schacht Value Investors often talks about the tenets of our investment process: Circle of Competence, Intrinsic Value, Margin of Safety, Catalysts, Active Ownership, and Sell Discipline. Our work doesn't end with identifying attractive investments and buying shares.

We are active owners of our portfolio companies. When necessary we engage a company's management and board of directors, because **"active ownership"** is not just a slogan. It is a means toward our investment ends. It is often necessary to create a catalyst to realize value for our clients, especially when the opportunity is great. Most often our discussions with management remain private, but sometimes it is necessary to go public.

This is the case with Rimage Corporation, a company owned in our client accounts.

For over a year, Schacht Value has tried to engage Rimage's management in a meaningful dialogue regarding the company's enormous cash balance and how the management plans to allocate it. To understand the debate, here is a description of Rimage's core business.

> *Rimage Corporation engages in the development, manufacture, and marketing of high-performance digital publishing systems that are used by businesses to produce recordable CD, DVD, and blu-ray discs with customized digital content on an on-demand basis. In addition, Rimage Corporation offers consumables consisting of media kits, ribbons, ink cartridges, parts, and Rimage-branded blank recordable CD, DVD, and blu-ray media. Additionally, it provides repair and installation services, as well as undertakes maintenance contracts. The company serves various markets, including digital photography, medical imaging, business services, law enforcement, and video workflows.*

This business isn't exciting or fast-growing, but it generates considerable amounts of cash that have piled up in the company's coffers. So much so that cash now dwarfs the operating business, turning Rimage into a glorified savings account.

In fact, Rimage holds nearly $120 million in cash and securities ($12+ a share) against a $146 million ($15.40 a share) market value. Most companies with this ratio of cash to market value are unprofitable or have obscene debt levels. But Rimage is nicely profitable and debt free. The company generated over $8 million in reported profit and around $12 million in free cash flow in the last 4 reported quarters.

So why is the underlying business, which generates these profits, only valued at $26 million ($146 - $120) by the market? Because investors are skeptical of the company's leadership, which wants to use the cash to acquire other firms in a bid for growth. CEO paychecks are primarily driven by the size of the firm in question. And CEO Sherman Black wants to grow.

Schacht Value likes growth, too. It is a very powerful variable in the value equation. But we worry the cost of Rimage's growth pursuit will outweigh the benefits. We also question the motivation behind the drive for diversification. It seems that shareholder value considerations are taking a backseat to other considerations. Mr. Black was recently quoted as saying "I'm used to managing billion dollar companies. I'm not gonna run a rinky dink operation… if the board ends up following Mr. Schacht's call of action, I'm gone."

A distribution of the firm's excess cash would limit how much capital was put at risk. It would also force the market to reasssess the value of the underlying business, which alone should be worth at least $80 million (or $9 a share). So cash plus the value of the operating business should be worth $21 a share or more. The catalyst starts with a massive special dividend to shareholders, which effectively unburies Rimage's business from the cash it has generated over the years. It also refocuses the management on the core business. No more pies in the sky.

Companies where NET cash (cash in excess of all debt) is greater than 80% of market value are exceedingly rare. In these cases, the underlying business is being assigned very little (if any) value, which is the case with Rimage. It is a signal (and indictment even) from investors that they believe management actions will destroy value. The history of corporate acquisitions proves that (more often than not) shareholder wealth is destroyed, not created.

This issue is put to rest if the excess cash is distributed to shareholders, safe from a CEO who is driven by ego and emotion. At the current price, Rimage doesn't have to grow to create shareholder value. Schacht Value clients have seen (via companies like Dr Pepper Snapple – DPS) that torrid revenue growth is not as important as intelligent capital allocation.

It is not surprising that the management team disagrees with our position. They see the cash as a means to escape the current core business and move to higher ground. When it comes to these matters, managers are often wrong, but seldom in doubt about the ultimate outcome. So our attempts to get a coherent (let alone favorable) response from management have failed. It is for this reason, that we sent the enclosed letter to the Rimage Board of Directors on March 2nd.

Since then, Schacht Value has been contacting other shareholders to gain support for this initiative. It is an effort that is finally gaining traction. In fact, Arcadia Capital, a firm with experience in these matters, has taken a position in Rimage and just sent a letter of their own.

As owners of Rimage, it is our capital at risk. Sometimes those running public companies need to be (gently) reminded of this fact. We'll keep you apprised of any major developments.

Many thanks for your continued support,

Henry W. Schacht, CFA

For more information on this issue, go to - **www.schachtvalue.com/rimage**, where you will find the Arcadia Capital letter, the Rimage CEO interview, the board of directors' response to our letter and more.

Poor management is able to persist because shareholders aren't willing to do anything about it. That inaction is an abdication of responsible ownership and fiduciary duty.

~ Jonathon Jacobson, Highfields Capital Management

The typical management will operate with more capital than necessary, if the stockholders permit it -- which they often do.

~ Benjamin Graham, *The Intelligent Investor*

SCHACHT VALUE INVESTORS, LLC

March 2, 2011

Board of Directors
Rimage Corporation
7725 Washington Avenue South
Minneapolis, MN 55439

Dear Members of the Board:

As shareholders of Rimage Corporation (Nasdaq: RIMG), Schacht Value Investors demands a change in the company's strategic direction and capital allocation. On behalf of our clients, who beneficially own 65,010 shares of Rimage, we request:

- A renewed focus on Rimage's core business and organic growth initiatives.
- An end to the search for acquisition targets.
- A special dividend of at least $100 million, or approximately $10 per share.
- Engagement of investment bankers about a possible sale of Rimage.

The company's enormous cash balance, which currently represents 80 percent of the company's market capitalization, is its largest source of shareholder value. Recent statements and actions by management raise serious concerns about the intentions for this capital. Over the past year, it has become increasingly clear that Rimage's leadership will primarily use the cash to pursue an "option" that includes acquisitions and a new "content delivery platform".

We disagree strongly with this direction.

The current market price of Rimage shares implies a value of $140 million. Two components contribute to this value: a profitable core business that generates significant free cash flow, which at the current market price carries a value of under $30 million, and at least $100 million in cash that investors could redirect without affecting the operation and value of that core business. Even if the core business declines, by any measure, its value should far exceed the $30 million currently being assigned.

Why does the market attribute such a paltry valuation to the core business? The market assigns a negative value to the aforementioned "option" that management hopes to pursue. While management may believe that the option represents the best use of company cash, the market correctly assumes that the option will instead destroy shareholder wealth. In fact, CEO Sherman Black reinforced the market's view only last week:

> **We have not given any financial estimates, because we don't have a firm business plan that we can share with you at this time. What we have shared with you, Steve, is that we have an existing business that we feel comfortable is going to continue to generate cash flow.**

We could not have said it better ourselves. Everything outside the core business is just an expensive experiment, a speculation with shareholder capital that we do not and will not support.

Focus on the Core Business

The operating portion of Rimage should be the largest component of enterprise value and the focus of management's efforts. Management may feel "comfortable (that it) is going to continue to generate cash flow", but the "option" is a major distraction that jeopardizes this progress.

Furthermore, instead of throwing an undefined amount of cash at the promised "content delivery platform," management should seek further organic growth in areas that truly relate to the existing business. By their own admission, management does not have a firm plan for their new business efforts. These ventures are ill-defined and promise to consume unknown quantities of shareholder capital.

To be clear, we do not oppose investing for the future. Rather we question the nature and extent of the needed investment. The Board of Directors must resist the institutional imperative to spend the enormous store of wealth.

End the Search for Acquisitions

If we were to write a book entitled "Successful Corporate Acquisitions", it would be a very slim text. The chapter covering technology companies would be slight to non-existent. Sherman Black acknowledged this during the 4th Quarter 2009 earnings conference call:

> **I can provide you with a lot of data that says companies that do what you just suggested [acquisitions] actually fail. And when you start looking multiple rings away from your core, your chances of success go way down. And that's been documented in many, many cases. I would rather – if I thought that's where I was going to go, I'd rather give the money back to the shareholders and let them decide where they want to take their investments.**

This remark reassured us as investors, but it has started to ring hollow in light of recent statements and developments. First and foremost, the company hired an investment bank to explore acquisition targets. We are reminded that you never ask a barber if you need a haircut!

Next, the Board of Directors this week changed management incentive compensation so as to actually encourage acquisitions. The company did not discuss or even identify this critical change during the most recent earnings conference call. We thus question the ability of the current Board of Directors to represent investor interests. To encourage behavior that will likely destroy shareholder wealth strikes us as irrational.

For at least a year, investors have questioned management (publicly and privately) about capital allocation plans, particularly in regard to Rimage's enormous and growing cash balance. Initially, management asked for time to formulate a plan, citing their short time on the job. More recently, it hinted at a plan that remains undisclosed, ill-defined, or both. Nonetheless, management assured shareholders that the cash is not burning a hole in the corporate pocket.

Hiring an investment bank and changing compensation incentives confirms investors' worst fears. Yet the Board of Directors expects us to sit passively, content with the cash balance in the hands of management, despite signs of imminent value destruction.

Despite the general lack of transparency, one thing is abundantly clear: there are no plans to disgorge excess capital back to shareholders, where it is desired and where it belongs.

Given the checkered history of corporate deal making, this should be the first option considered, not the last.

Shareholder after shareholder has raised the issue of a special dividend. Management has dismissed us every time, with excuses, platitudes, and outright condescension. Just review the enclosed litany of exchanges regarding Rimage's cash over the last 5 quarters (attached).

Management forgets that investors own this capital. Yet management ignores investor calls for a pro-rata share of our own cash, in favor of management ambitions, unspecified customer requests, a call for growth by the Board of Directors, and whatever gem our new investment bankers may uncover. We should not have to wait at the end of the line for our own capital.

If shareholders needed further evidence of the company's intentions, we need only cite Sherman Black's recent statement that accelerating growth at Rimage "will require some inorganic activity, and we're looking at those options". Such veiled references to acquisitions only provide further proof that management understands the unpopularity of the "acquisitions first" course.

Declare a Special Dividend

Numerous academic studies and countless examples show clearly that large excess cash balances erode management discipline and shareholder returns. Yet management ambitions often override financial concerns when shareholders fail to intervene. Even Warren Buffett himself has weighed in on these issues saying he prefers smaller companies with higher returns on capital to bigger ones with lower returns.

Investors will not allow Rimage to become a venture capital fund. **Most of Rimage's shareholders are professional investors with a far greater capability to reinvest this capital, with the track records to prove it.** Investors, including Schacht Value, have a wider choice of possible investments outside the company's rather specific area of technology.

The company could easily return at least $100 million to shareholders and still have more than enough cash for organic opportunities and working capital. Even a distribution of this size would leave some $16m in cash to support $80m-$85m in 2011 sales. Management must demonstrate why they could not operate the current business and invest for the future with this level of remaining cash (post distribution), ongoing free cash flow, and a debt free balance sheet.

We therefore request that the Board declare a special dividend of at least $100 million. This special dividend would be additive to the regular dividend, not a replacement.

Investigate Possible Company Sale

With a low enterprise value multiple, large cash balance, and steady free cash flow capabilities, Rimage makes a natural target, not an acquirer. The only reason to hire an investment banker would be to sell the company. We can't name a single "minnow-swallows-whale" acquisition that succeeded. Even "bolt-on" acquisitions are a mixed bag in terms of success.

Thus, in the interest of exploring all avenues of shareholder value maximization, we request that the Board of Directors engage an investment bank to solicit offers for Rimage. The best option for shareholders may well be a sale of the company, but we won't know unless the Board of Directors explores the possibilities.

Further Comments

In anticipation of one response to our request, let us acknowledge the company's steps to respond to shareholder discontent: engaging in modest share repurchases and declaring a regular dividend. These decisions, however, do not address the huge amount of cash in question or the risky steps being taken elsewhere in the name of growth.

For instance, despite the recently announced buyback activity, shares outstanding have actually increased. Clearly, the benefit of the share repurchases has not accrued to shareholders. Instead, it represents a wealth transfer (via stock options) to employees, making what was implicit explicit. Management only uses the share repurchases to the extent needed to offset option dilution. Whatever the portrayal, this is not a serious effort to return capital to shareholders.

Investors welcome a regular dividend as a necessary step for Rimage, but it does not address the company's outsized cash balance. Barring any special dividend, cash will likely continue to grow, unless management wastes it on an acquisition.

So when it comes to addressing the cash hoard and/or returning a significant amount of cash to shareholders, the above activities are merely window-dressing.

Conclusion

It is time the Board of Directors upholds its fiduciary duty to protect shareholders from the management team's ambitions, directing them to run the business at hand. While day-to-day operations may not have the glamour and intrigue of so-called "strategic matters", Rimage investors believe they are a better use of management's time, and our money.

Send a clear signal to existing shareholders and the wider investment community that Rimage will not burn its cash in a misguided attempt to discover the next "big thing". The Board of Directors must consider all options for increasing value, including a sale of the company. In the meantime, the company must return excess cash to its owners.

Leave eager investment bankers and their shopping lists for others. By doing so, you will distinguish Rimage as a true steward of shareholder capital and likely cause a positive reappraisal of the company's value.

In short, we trust management to run its existing business, not to allocate over $100 million in shareholder capital on new ventures.

Numerous concerned shareholders have patiently tried to work with management to address capital allocation. Our reasonable concerns have fallen on deaf ears. For this reason, we have lost confidence in the company's intentions and abilities in regard to our capital.

We therefore appeal to the Board of Directors to weigh in. Please fulfill your obligation to protect shareholder value. By considering only acquisitions and token displays of affection for shareholders, directors risk being held accountable by investors for any destruction of shareholder value that results.

We await your response.

Sincerely,

Henry W. Schacht, CFA

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