SIMPLETECH INC
Form 10-K
March 31, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO

SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 000-31623

SIMPLETECH, INC.

(Exact Name of Registrant as Specified in Its Charter)

California	**33-0399154**
(State or Other Jurisdiction of	**(I.R.S. Employer**

Incorporation or Organization) **Identification No.)**

3001 Daimler Street

Santa Ana, California 92705-5812

(Address of principal executive offices, including zip code)

Registrant s Telephone Number, Including Area Code: (949) 476-1180

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $0.001 par value	The Nasdaq National Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 in the Exchange Act.

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer x

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

As of June 30, 2005, the last business day of the registrant s most recently completed second fiscal quarter, the approximate aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant was $65,079,777 (based upon the last closing price for shares of the registrant s common stock as reported by The National Market System of the National Association of Securities Dealers Automated Quotation System as of that date). Shares of common stock held by each officer, director, and holder of 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 1, 2006, there were approximately 45,112,568 shares of common stock outstanding.

Documents Incorporated By Reference

Certain information required in Part III hereto is incorporated by reference to the Proxy Statement for the Registrant s 2006 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Form 10-K.

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FORM 10-K ANNUAL REPORT

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This Annual Report on Form 10-K, including information incorporated herein by reference, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to expectations concerning matters that are not historical facts. Words such as projects, believes, anticipates, will, estimate, plans, expects, intends, and similar words and expressions are intended to identify forward-looking statements. Although we believe that such forward-looking statements are reasonable, we cannot assure you that such expectations will prove to be correct. Important language regarding factors which could cause actual results to differ materially from such expectations are disclosed in this Report, including without limitation under the caption Risk Factors beginning on page [16] of this Report. All forward-looking statements attributable to SimpleTech are expressly qualified in their entirety by such language. We do not undertake any obligation to update any forward-looking statements.

We own or have rights to product names and trademarks that we use in conjunction with the sale of our products, including but not limited to Simple®, SimpleTech®, Bonzai®, IC Tower®, SimpleDrive®, Bonzai Express , Postage Stamp , SimpleDrive Desktop , SimpleDrive Mini , SimpleDrive Portable , SimpleShare and SimpleTransfer .

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PART I.

ITEM 1. BUSINESS

Overview

SimpleTech, Inc. designs, develops, manufactures and markets custom and open-standard memory solutions based on Flash memory and DRAM technologies and external storage solutions. Headquartered in Santa Ana, California, we specialize in developing high-density DRAM memory modules and high-speed, high-capacity solid-state Flash drives and memory cards used in sensitive and highly-volatile environments. We offer a comprehensive product line, including Flash and DRAM-based memory solutions and external hard drive storage solutions used by consumers and original equipment manufacturers, or OEMs. We believe this allows us to service a diverse customer base with multiple memory formats thereby enabling our customers to purchase all of their memory requirements from one supplier.

We offer memory and external hard drive storage solutions through our Consumer and OEM Divisions. Our Consumer Division sells open-standard memory and storage products such as Flash cards, DRAM modules, USB mini drives and hard disk drives which are used primarily as upgrades in consumer electronic devices and computing systems. We believe our comprehensive line of products allows our customers to efficiently manage their inventory purchases and therefore reduce their costs by consolidating their purchases of memory and storage products into a single vendor. Our OEM Division sells primarily customized memory solutions for newly-manufactured systems, with most sales based on a cooperative design effort between our design engineers and our OEM customers. We believe the ability of these equipment manufacturers to shorten product development cycles and accelerate time-to-market is critical to their success. In response to this trend, we believe equipment manufacturers are increasingly outsourcing the design, development and manufacturing of memory products to third-party memory providers, such as SimpleTech. We believe our design, manufacturing, testing and logistics expertise, along with our proprietary technologies, enable us to respond quickly to our customers rapidly changing product and service requirements as well as meet their time-to-market schedules.

We are focusing on several revenue growth initiatives, including:

- Developing and qualifying customized OEM Flash-based products, including our Zeus product line, for industrial applications;
- Targeting new customers for our value-add OEM DRAM memory solutions;
- Increasing retail sales of our storage product line; and
- Expanding our international OEM business in Asia and Europe.

Our Flash business has expanded over the past year primarily as a result of the growing number of OEM applications in which Flash drives are replacing rotating disk drives due to improved performance, reliability and size. These OEM applications include military subsystems, in-flight information systems, casino-gaming systems, embedded controls for industrial automation and medical equipment. Over the past several years we have expanded our custom design capabilities of Flash products for OEM applications and have designed proprietary industrial-grade Flash controllers. OEM Flash product revenue increased 12% from $20.1 million in 2003 to $22.6 million in 2004, and increased 66% from 2004 to $37.6 million in 2005. We expect our continued investments in OEM Flash controller development to result in continued revenue growth from our OEM Flash product line in 2006 and beyond. OEM Flash product gross margins are typically significantly higher than our Consumer Flash product gross margins and were our highest gross margin product line in 2005.

During 2005 we also expanded our OEM Flash business through our acquisition on July 13, 2005 of Memtech SSD, Corporation, a provider of ultra-rugged and reliable solid state Flash drives. The acquisition highlighted our continuing commitment to the OEM Flash market and enabled us to create one of the most comprehensive offerings of solid state drives and other Flash-based solutions for industrial and military applications.

Our DRAM products target primarily high-performance computing applications, including switches, routers, high-end servers, workstations, desktops and notebooks. As the applications that we serve expand and as the complexity of these applications increases, the need for the customization of our products in these applications also increases. We have developed proprietary technologies to address the increased need for

customized solutions. For example, our patented IC Tower® stacking technology allows multiple memory chips to be stacked together to increase the capacity of a memory module without expanding its footprint. This technique increases memory board density significantly over conventional techniques and is particularly well-suited for applications where high memory capacity, cost and space are critical.

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We offer monolithic DRAM memory modules and DRAM memory modules based on our stacking technology. The majority of our Consumer DRAM business has been comprised of monolithic DRAM memory modules. Prior to 2005, a substantial portion of our OEM DRAM business had been comprised of stacked DRAM memory modules. As a result of the introduction of new DRAM technologies, we expect that a higher percentage of our OEM DRAM business will be derived from monolithic DRAM memory modules. During 2005, we faced transitional challenges as some of our OEM DRAM customers transitioned from modules based on PC 2100 to PC 2700 and from DDR I to DDR II technologies. Our OEM monolithic and stacked DRAM memory module revenue decreased from $107.7 million in 2004 to $90.0 million in 2005. We plan to introduce DRAM components utilizing our next generation Postage Stamp stacking technology, based on the latest generation ball grid array, or BGA, in the first half of 2006. We expect our OEM stacked DRAM memory module business to remain difficult to project for the next several quarters as our customers continue to qualify the latest generation modules.

Our various storage products are designed to address the increasing need for expanded, reliable digital storage. The storage product line consists of the following five categories: (1) SimpleShare, the network attached storage product category that enables users to add shared storage to a network, (2) SimpleDrive the desktop external storage product category which enables fast, reliable back-up and expanded storage volumes, (3) SimpleDrive Portable, the mobile storage product category which enables truly mobile back-up storage, (4) SimpleTransfer, the data migration product category that permits efficient data transfer among multiple PCs and (5) notebook hard drive upgrades. The essence of the SimpleTech storage product family is fast, reliable storage and back up capabilities for desktop or notebook computers so that users can create media libraries for their digital music, movies and photographs, or add gigabytes of additional storage to accommodate expanding storage needs.

In the past year, we have invested significantly in the design, development and launch of our SimpleShare product line of network attached storage, or NAS, external drives. During 2005, we initiated external drive launches into numerous major U.S. retailers and external storage drive revenue increased 32% from $10.9 million in 2003 to $14.4 million in 2004, and increased 144% from 2004 to $35.2 million in 2005. We expect to continue to grow our external storage drive business in 2006.

Industry Background

The memory market can be divided into several types of integrated circuit, or IC, devices that are designed to perform specific functions within computer and other electronic devices or systems. Two of the major types of memory products are Flash and DRAM. Flash is considered a non-volatile memory since it is able to retain data without a power source. Since DRAM requires a constant power supply to retain data, it is considered volatile memory. DRAM has historically dominated the memory industry in terms of market size and scale of production and continues to be one of the highest volume semiconductors manufactured today. In recent years, the memory market has expanded to include Flash due to the proliferation of consumer electronic devices designed to allow increasing user mobility. The growth in shipments of these consumer electronic devices and their unique and expanding storage requirements have led to the increased demand for Flash memory products.

The Flash memory industry is divided into two primary segments: data storage, or NAND, and code storage, or NOR. Data storage Flash products are commonly used for storing large volumes of data in small form factor and in environments characterized by high levels of shock, vibration or temperature fluctuation. In contrast, code storage Flash products are typically used in less memory-intensive applications. Substantially all of our Flash product revenues are derived from the sale of data storage Flash products. Data storage Flash products are used primarily to store digital content such as pictures, digital music, video clips and files in consumer electronic devices such as digital cameras, MP3 digital audio players, PDAs, digital camcorders and smart phones. The demand for these consumer electronic devices has grown rapidly. In addition, these consumer electronic devices have become smaller in size while requiring increasing amounts of memory which is driving the demand for high-density, small form factor Flash memory solutions. Flash memory is noiseless, considerably lighter, more rugged, free of mechanical moving parts and consumes substantially less power than a rotating disk drive. These characteristics also make Flash drives a better storage alternative than rotating disk drives in extreme environments such as those often found in the military, aerospace and communication applications.

The growth in the DRAM industry is driven by unit growth in the markets for PCs, high-performance workstations, servers, switches, routers and the Internet infrastructure. In addition, DRAM growth is fueled by an increasing amount of memory content used in these systems. We also anticipate that the expected PC replacement cycle and resumption of IT spending will continue to drive the demand for DRAM memory.

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The Flash and DRAM memory supply chain consists of numerous participants including semiconductor manufacturers, third-party module and card manufacturers and a variety of distributors and mass market retailers who sell to end-users. Major memory semiconductor manufacturers have focused primarily on large volume opportunities, producing open-standard modules and cards as base-level memory for the leading OEMs of desktops and notebooks, digital cameras, cell phones and other mass markets. In contrast to serving the base-level memory needs of these OEMs, third-party module and card manufacturers, such as SimpleTech, provide open-standard upgrades used by consumers. In addition, we believe the increasing complexity of computing systems as well as the demands placed on them has caused OEMs to rely increasingly on third-party design and manufacturing of custom memory products in which open-standard modules and cards are not adequate.

The growth in the external storage industry is driven primarily by the trend of increasing requirements to store digital music, movies and photographs and the desire for reliable back up for these digital files. Our storage solutions enable fast, user-friendly, back up and retrieval of such files and certain products allow users to add shared storage to their network.

The SimpleTech Solution

SimpleTech designs, manufactures and markets a comprehensive line of memory and storage products used in consumer electronics, high-performance computing, defense and aerospace systems, networking and communications and other OEM applications. We believe our comprehensive line of products allows our customers to efficiently manage their supply chains by consolidating their memory and storage product purchases.

Product Features

High degree of customization. Products sold to our OEM Division customers are typically customized by our design and engineering teams to meet our customers specific design requirements.

High density. Our patented stacking technology allows us to design and manufacture Flash cards and DRAM memory modules in which multiple memory chips are stacked together to increase the capacities of memory modules without increasing the product footprint. In some cases, our IC Tower stacking memory technology allows us to create a high capacity solution that is otherwise not currently available in the market using standard modules, and in other cases it allows us to provide the same capacity as a standard module at a lower price point.

Compact size. We are able to manufacture high-density Flash and DRAM memory products with some of the smallest footprints in the market. As component chips increase in capacity, we are able to increase density in the same footprint.

High performance and reliability. Our memory products are built utilizing sophisticated error detection and correction processes to provide high data reliability and integrity. In addition, our memory products are designed to withstand high levels of shock and vibration as well as extreme temperature fluctuations typically associated with mobile computing and OEM applications.

Low power consumption. During read and write operations, Flash memory products typically use less power than rotating disk drives. At all other times during system operation, Flash memory products require no power. This low power consumption translates into longer battery life for many mobile computing and consumer electronic devices.

Consumer Division

Our Consumer Division sells open-standard memory storage products such as Flash cards, DRAM modules, USB mini drives and hard disk drives used as upgrades in or enhancements to consumer electronics and computing systems. Our Consumer Division sells our products through the following channels: value added reseller, or VAR, mail order, distributor, and mass market retailer. We believe we are able to strengthen our relationships with our Consumer Division customers and develop the SimpleTech brand name through various marketing programs, such as volume purchase rebates, joint marketing, account manager incentives and lead generation. We also provide ongoing customer support, including on-line pricing and navigation tools, toll-free technical support and account manager training programs.

OEM Division

Our OEM Division sells primarily customized memory solutions for newly-manufactured systems, with most sales based on a cooperative design effort between our design engineers and our OEM customers. We offer our OEM Division customers a comprehensive technology solution from concept to design to the creation of prototypes through volume production and

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testing. We believe our quick-turn design capabilities and automated manufacturing and test processes allow our OEM Division customers to quickly and cost-effectively bring products to market. In addition, our capabilities allow our OEM Division customers to focus their resources on activities and technologies in which they add the greatest value, such as system design, sales, marketing and distribution. We believe our technical capabilities and manufacturing strengths allow our OEM Division customers to cost-effectively design and implement advanced memory chip technology in high-volume product applications.

Products

We offer a comprehensive line of memory and storage products using our proprietary design and manufacturing technologies. Substantially all of our Flash and DRAM memory products comply with industry standards and are based on a variety of industry architectures. Sales of Flash memory and DRAM products collectively accounted for 86.3% and 94.3% of our total revenues in 2005 and 2004, respectively. Sales of storage products accounted for 13.7% and 5.7% of our total revenues in 2005 and 2004, respectively.

Flash Products

Our Flash products are used in a wide base of applications, ranging from high-capacity, highly reliable industrial applications to high performance networking applications to mobile consumer electronic devices. The primary focus of the SimpleTech Flash offering is manufacturing Flash products for use as an embedded storage device within OEM applications. At the heart of each SimpleTech Flash product is a controller designed by SimpleTech for the rigors of demanding OEM applications, offering industry-leading performance, reliability and flexibility.

We offer a broad line of Flash products in various form factors and capacities, including:

CompactFlash memory cards. CompactFlash products provide full PC Card AT Attachment, or ATA, functionality, but are only one-fourth the size of a standard PC Card. CompactFlash memory cards are characterized by its small size, durability, low power consumption and the ability to operate at either 3.3 volts or 5.0 volts. CompactFlash products provide interoperability with systems based on the PC Card ATA standard by using a low-cost passive adapter, thus making CompactFlash widely used by a variety of applications.

Secure Digital and MultiMediaCard Flash memory cards. Secure Digital, or SD, and MultiMediaCard, or MMC, Flash memory cards are used in data storage applications and are about the size of a postage stamp. Their slim, compact design makes them an ideal removable storage solution for designs including mobile phones**,** audio players, digital cameras, and other space-constrained applications.

miniSD and Reduced-size MultiMedia cards. miniSD and reduced-size MMC, or RS-MMC, Flash memory cards are designed to meet the demanding storage needs of the growing mobile phone and handheld device market. MiniSD and RS-MMC easily convert into standard SD and MMC cards with an adapter to provide interoperability with existing SD and MMC card slots, adding functionality for digital cameras, MP3 music players, digital camcorders and PDAs that use standard SD and MMC cards.

USB Flash drives. Our USB Flash drive portfolio consists of the embedded Bonzai Xpress and the upgradeable Bonzai which utilizes either an SD or MMC Flash memory card. The Bonzai offers greater capacity options since users can easily replace or upgrade the SD or MMC Flash memory card to enable the use of multiple Flash memory cards on the same Bonzai, upgrade of the Bonzai to higher storage capacities and the use of a single Flash drive among multiple devices.

ATA Flash PC cards. Our ATA Flash PC Cards are used in storage, data backup and data logging applications. Our products are available in the industry standard PC Card Type II form factor.

Solid State Drives. Our solid state drives are designed to meet the data storage requirements of a wide range of industries, including the defense and aerospace, automotive and transportation, industrial and communications industries. They are drop-in replacements for traditional hard drives and are a superior substitute for hard drives in systems that require sustained operation in harsh environments, low-power consumption, content security, fast data transfer speeds, and high-capacity storage. Typical applications include data recorders, rugged PCs, industrialized servers, telecommunications equipment, and other mission-critical applications. Our solid state drives are available in standard hard drive form factors and interfaces, such as IDE/ATA, SATA, SATA + USB, and can be combined in multiple form factors to include 2.5-inch, 3.5-inch and custom enclosures.

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Flash disk modules. Our Flash disk module products target embedded systems where device footprint is a critical parameter. There is no electrical circuitry or software interface change required when replacing a standard hard drive with a Flash disk module. The main benefit of Flash disk modules is that they are easier to incorporate into designs because they are less than one-quarter the size of a 2.5-inch hard drive and they plug directly into the motherboard, thereby eliminating the need for cables. Specifically, the product line is available in a 44-pin configuration, which addresses similar functionality to a 2.5-inch hard disk drive, and a 40-pin configuration, which addresses similar functionality to a 3.5-inch hard disk drive.

The following table describes certain of our Flash modules as of March 1, 2006:

Data Storage Flash Product Family	Density		Form Factor
Cards:			
Compact Flash	64MB	16GB	Type I (36.4mm x 42.8mm x 3.3mm)
Secure Digital	64MB	4GB	9-pin
MultiMediaCard (Plus)	128MB	2GB	13-pin
ATA Flash PC Cards	64MB	16GB	Type II (54.0mm x 85.6mm x 5.0mm)
USB Flash Drives:			
Bonzai Xpress	128MB	2GB	USB Flash drive
Bonzai	64MB	1GB	Upgradeable USB Flash drive
Solid-State Drives	64MB	256GB	2.5 inch, 3.5 inch and custom
Flash Disk Modules:			
40-pin	64MB	4GB	40-pin vertical & horizontal; 40-pin low profile horizontal
44-pin	64MB	4GB	44-pin vertical & horizontal

DRAM Products

We offer a full range of DRAM products, including dual in-line memory modules, or DIMMs, small-outline, or SO, DIMMs, mini-registered DIMMs, or mini-RDIMMs, very low profile, or VLP, RDIMMs and Fully-Buffered DIMMs, or FB-DIMMs. Our DRAM products are used primarily as personal computer, notebook and server upgrades and in higher performance computing, communications, and industrial applications. Our standard DRAM products are available in various memory module form factors and densities of up to 4GBs. We also offer many of these products utilizing different DRAM architectures such as FB-DIMM, DDR, DDR2, SDRAM and RDRAM.

The following table describes certain of our non-stacking DRAM products as of March 1, 2006:

DRAM Product Family	Density		Architecture	Speed (MHz)	
240-pin Fully-Buffered DIMM	512MB	2GB	DDR2	533	667
168, 184 and 240-pin Unbuffered DIMM	128MB	2GB	SDRAM, DDR, DDR2	266	800
168, 184 and 240-pin Registered DIMM	256MB	2GB	SDRAM, DDR, DDR2	100	667
184 and 240-pin Very Low Profile DIMM	1GB	2GB	DDR, DDR2	333	667
244-pin mini-DIMM	512MB	1GB	DDR2	400	667
200-pin SO-DIMM	128MB	1GB	DDR, DDR2	266	800
144-pin SO DIMM	64MB	1GB	SDRAM	100	133
100-pin DIMM	64MB	512MB	SDRAM, DDR	100	266
Rambus DIMM	64MB	512MB	RDRAM	800	1066

Stacked DRAM and Flash Products

IC Tower stacked components. Our patented IC Tower semiconductor stacking technology enables the manufacture of very high capacity memory products. We offer a wide selection of stacked components for both TSOP and BGA semiconductor packages for use on memory modules and within our high capacity Flash products. This technology is used in complex, high-capacity module designs and systems. It provides a cost effective solution for our customers by offering chip densities that are less expensive than non-stacked components on a per

megabyte, or MB, basis.

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The following table describes certain of our IC Tower stacking components as of March 1, 2006:

		(Architecture)	
IC Tower Stacked Component Product Family	**Component Density**	**Capacity**	**Speed (MHz)**
DDR, DDR2	512Mb 1Gb	2 High (1GB 2GB)	266 667
SDRAM	256Mb 1Gb	2 High (0.5 GB 2GB)	100 133

DRAM modules and Flash card products with stacked components. We have a range of custom and application-specific stacked DRAM modules across multiple DIMM form factors in capacities up to 4GB. Our stacked DRAM products are used primarily in high-performance servers, workstations, switches and routers, and other custom systems. We offer many of these modules utilizing different DRAM architectures such as double data rate, or DDR, and DDR2, and synchronous DRAM, or SDRAM. Our stacked Flash products are used primarily in embedded systems and high-end consumer digital applications, such as professional digital cameras and camcorders.

The following tables describe certain of our stacked DRAM and Flash card products as of March 1, 2006:

Stacked DRAM Product Family	**Density**	**Architecture**	**Speed (MHz)**
168, 184 and 240-pin Registered DIMM	1GB 4GB	DDR, DDR2 SDRAM	100 667
184 and 240 pin Very Low profile DIMM	2GB	DDR, DDR2	333 667
168, 184 and 240-pin Unbuffered DIMM	1GB 2GB	DDR, DDR2, SDRAM	100 800
244-pin mini-DIMM	2GB	DDR2	400 667
144 and 200-pin SODIMM	512MB 1GB	DDR, DDR2, SDRAM	100 800

Stacked Flash Product Family	**Density**	**Form Factor**
CompactFlash	16GB	Type II (36.4mm × 42.8mm × 5.0mm)
Solid-State Drives	8GB 256GB	2.5 inch, 3.5 inch and custom

Storage Products

SimpleTech has a comprehensive line of hard drive-based external storage solutions for small businesses and consumers. The demand for mass storage products continues to surge as digital information and media proliferates. The SimpleTech product offering combines portability with ease of use for storing precious media.

SimpleDrive Family of Direct-Attached External Storage Products. We offer the SimpleDrive line of storage devices for data storage and back-up. Our SimpleDrive Desktop product line provides high-density, high-speed, cost-effective storage in 160GB to 500GB capacities. Our SimpleDrive Portable product line offers similar features in a smaller, more durable form factor in capacities ranging from 40GB to 100GB. The primary usage of these external hard drives is for easy, plug and play storage expansion and system backup. Our SimpleDrive Mini product line offers the smallest form factor available for disk drive based external storage with a capacity of 4GB.

Notebook Hard Drive Upgrade kits: We offer hard drive upgrade kits for most major brands of notebook PCs. Our products range in capacity from 40GB to 100GB. The primary use of these products is to enhance the storage capacity of notebook PCs.

SimpleShare - Network Attached Storage: SimpleShare enables users to quickly and easily add up to 500GB of storage capacity to most computer networks. SimpleShare is the easy way to store and share data over most computer networks.

The following table describes certain of our storage products as of March 1, 2006:

Storage Product Family	**Density**	**Connectivity**
SimpleDrive Portable	40GB 100GB	USB

SimpleDrive Mini	4GB	USB
SimpleDrive Desktop	120GB 500GB	USB, USB/FireWire
SimpleShare NAS Storage Server	160GB and 500GB	Ethernet 10/100 Base T
Notebook Hard Drive Upgrades	40GB 100GB	IDE

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Research and Development

Our research and development staff develop reliable, high-performance and cost-effective memory products to address the needs of traditional and emerging memory applications. We believe the timely development of new products is essential to maintaining our competitive position. Our engineering staff, which consisted of 37 persons as of December 31, 2005, works closely with our OEM Division customers and provides services throughout the production cycle, including component selection, schematic design, layout, manufacturing and test engineering expertise. We design our products to be compatible with existing industry standards and, where appropriate, develop and promote new standards. An important aspect of our research and development effort is to understand the challenges presented by our OEM Division customers custom design requirements and satisfy them by utilizing our proprietary technologies and our technical expertise. In the course of meeting our customers challenges, we are often required to develop new technologies and processes, which are later added to our design library. Our design library consists of over 1,000 designs that are available for a wide variety of custom and open-standard product configurations. In recent years, we have focused on designing and developing custom, industrial-grade Flash controllers. In January 2006, we purchased certain fixed assets and intellectual property and hired 18 engineers from a Flash controller design company in Taiwan. We plan to continue to invest in and expand our custom industrial-grade Flash controller portfolio in future years in order to maintain our leadership position in the OEM Flash market.

We continually improve our manufacturing processes and technologies, test routines and related firmware. We plan to continue to direct our research and development efforts toward the design of new memory products, which address the requirements of our Consumer and OEM Division customers. Our IC Tower stacking technology is a critical component of our research and development effort as it allows us to design solutions that are continually migrating to higher densities for our customers. Our IC Tower stacking technology enables us to produce high-density Flash and DRAM products by manufacturing products in a three-dimensional form. We plan to introduce DRAM components utilizing our next generation Postage Stamp stacking technology, based on the latest generation BGA components, in the first half of 2006. These products offer higher-density capacities in the same footprint as the traditional two-dimensional designs. We stack unmodified memory devices to produce higher-density and smaller form factor Flash cards and DRAM modules. We believe this capacity enables us to shorten our customers design cycles for high-density products to lead times normally associated with non-stacked memory solutions. In response to the growth in Flash-based applications, we are focusing on new Flash solutions that provide improved storage capacities, higher-speed read and write capabilities, smaller sizes and new interfaces. Research and development expense were $6.6 million, $4.3 million and $2.4 million for the three years ended December 31, 2005, 2004, and 2003, respectively.

Design, Manufacturing and Test

Design and production. The typical production cycle consists of a design stage followed by a prototype stage and ends with full production of the final product. We believe the length of the design stage has been reduced due to rapid improvements in technology. In recent years customers have demanded shorter design and production cycles. In response, we have developed quick-turn design and manufacturing services. By working with our OEM Division customers early in the design and prototype stages, we believe we are able to resolve critical design issues effectively and efficiently, thus shortening the time from prototype design to volume manufacturing. In addition, we believe working closely with our OEM Division customers throughout the design and production stages allows us to gain important insights into their future product requirements. We believe our quick-turn design and manufacturing services also allow us to introduce upgraded products to the consumer market on a timely basis to coincide with new product releases by these customers.

Manufacturing. Our manufacturing processes are highly-automated and involve the use of specialized equipment for the production of memory products. Our manufacturing systems have been optimized to support the placement of a large number of IC devices on each memory board. We believe we are able to achieve a high manufacturing yield and minimize direct labor costs as a result of our design efficiencies, high level of automation and general manufacturing expertise. Because our manufacturing systems can be easily configured for different memory products, we have the ability to offer our customers short manufacturing and test cycles on small and large projects. We also have developed an automated method of manufacturing our IC Tower stacking products which we believe results in further manufacturing efficiencies. Our manufacturing process is ISO 9001 certified.

Test engineering. An important aspect of our manufacturing operations is our focus on test engineering. We test all of our memory products upon completion of manufacturing, which we believe results in low returns due to product defects. We believe our test engineering expertise will continue to grow in importance as the speed and complexity of memory products increase. Our test engineering group develops proprietary processes which, together with our continued investment in advanced testing equipment, have enabled us to consistently produce high-quality products.

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Customers

We sell our products through our Consumer and OEM Divisions. We have no long-term sales contracts with our customers. Our Consumer Division sells our products through a variety of distribution channels, including VARS, mail order, distributors, and mass market retailers. Our OEM Division markets our products to OEMs, leveraging our custom design capabilities to offer custom memory solutions to address their specific needs. Our ten largest customers accounted for an aggregate of 65.9%, 68.4% and 51.9% of our total revenues in 2005, 2004 and 2003, respectively. Smart Modular, Micron Semiconductor and CDW accounted for 18.4%, 15.0% and 15.0%, respectively, of our total revenues in 2005 and accounted for 13.7%, 21.3% and 17.9%, respectively, of our total revenues in 2004. CDW Computer Centers accounted for an aggregate of 19.2% of our total revenues in 2003. As of December 31, 2005, 2004 and 2003, approximately 43.0%, 38.4% and 21.3% of accounts receivable were concentrated with four, three and two customers, respectively. No other single customer accounted for more than 10.0% of our total revenues or accounts receivable in 2005, 2004 or 2003.

Consumer Division

In 2005, our Consumer Division sold to more than 500 customers through VARs, mail order, distributors, and mass market retailers. In addition, through our consumer distribution arrangements, we supply certain of our products to e-commerce companies for their sale of these products on the Internet.

OEM Division

In 2005, our OEM Division sold to more than 200 customers, including sales through OEM distributors and contract manufacturers that incorporate our products into systems they assemble for our OEM Division customers. We define our OEM Division customers as OEMs that have purchased our products directly or ordered our products from OEM distributors and contract manufacturers. Our OEM Division customers make the purchasing decisions on substantially all of the products we sell through OEM distributors and contract manufacturers. For additional information regarding our business segments, see Note 13 to our Consolidated Financial Statements.

We expect that sales of our products to a limited number of customers will continue to represent a majority of our revenues for the foreseeable future and believe that our financial results will depend in significant part upon the success of our customers businesses. We have experienced changes in the composition of our major customer base from quarter to quarter as the market demand for our customers products have changed and we expect this variability to continue in the future. For risks associated with our customer relationships, see Risk Factors Sales to a limited number of customers represent a significant portion of our revenues and the loss of any key customer would materially reduce our revenues.

International sales of our products accounted for $33.8 million, or 12.9%, $50.3 million, or 18.2%, and $39.8 million, or 18.8%, of our total revenues in 2005, 2004 and 2003, respectively. In 2003, Europe accounted for $21.9 million, or 10.3%, of our total revenues. No other foreign geographic area or single foreign country accounted for more than 10.0% of our total revenues in 2005, 2004 and 2003. Substantially all of our international sales are export sales, which are shipped from our domestic facility to foreign customers. For additional information regarding our international sales, see Note 13 to our Consolidated Financial Statements and Risk Factors We face risks associated with doing business in foreign countries, including foreign currency fluctuations and trade barriers, that could lead to a decrease in demand for our products or an increase in the cost of the components used in our products.

Sales and Marketing

Consumer Division

We ship SimpleTech brand-name products directly to VARs, mail order, distributors and mass market retailers. In addition to in-house sales representatives, our sales efforts in the consumer channel are supported by manufacturers representatives. For the mail order and mass market retailer channels, we advertise in magazines and newspapers as a way of bringing end-users to our customers locations. We offer certain VARs volume rebates and work with their customers to qualify our products for their information system departments. Volume rebates are used to incentivize certain resellers, rewarding them with a rebate for our products sold. For consumer distributors, we purchase corporate image advertising, offer volume rebates and joint marketing programs, and generate leads at electronics tradeshows and refer those potential customers to our distributors. Through joint marketing programs, we work together with resellers to incorporate the SimpleTech brand in the resellers existing marketing plans, such as catalogs and web banner ads. In addition, we have developed direct advertising programs with certain of our consumer distributors e-commerce customers in which we market our products on their websites. We also offer account manager incentives, which include sales contests and reward programs designed to sustain reseller loyalty while also creating excitement for increased sales activity.

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OEM Division

Our OEM Division uses an internal direct sales force complemented by an external sales force of manufacturers representatives and OEM distributors for sales to OEM Division customers in the United States and internationally. We pursue our customer base on both a geographic and account-specific basis. We believe these combined sales forces have the local presence, market knowledge and strategic insight to allow us to more effectively market our products to a larger number of OEM customers. In addition, as part of our sales and marketing efforts, our experienced applications engineers work closely with our OEM Division customers in designing our products into their systems.

Customer Service and Support

We provide our customers with comprehensive product service and support. We work closely with our OEM Division customers to monitor the performance of their product designs and to provide application design and support. This also provides us with insight into defining their subsequent generations of products. Our standard OEM Division customer support package is generally offered with all product sales and includes full technical documentation and application design assistance. During our OEM Division customers production phase, we provide extensive support which includes training, system-level design, implementation and integration support. We believe that tailoring our technical support to our OEM Division customers needs is essential to the success of our product introductions and customer satisfaction. Our Consumer Division customers receive technical support on an unlimited, toll-free basis and are assigned a dedicated technician familiar with their account. We also train the account managers of certain Consumer Division customers to keep them informed about changes in our product lines. In addition, we offer Consumer Division customers on-line pricing and navigation tools, and a personalized web page available through our extranet which features personalized information such as promotions, new products and contact information.

Competition

We conduct business in an industry characterized by intense competition, rapid technological change, evolving industry standards, declining average sales prices and rapid product obsolescence. Our primary competitors in the third-party memory module industry include: Crucial Memory, a division of Micron Technology, Kingston Technology, Lexar Media, M-Systems, PNY Technologies, SanDisk, and SMART Modular. Our competitors include many large domestic and international companies that have substantially greater financial, technical, marketing, distribution and other resources, broader product lines, lower cost structures, greater brand recognition and longer-standing relationships with customers and suppliers.

We expect to face competition from existing competitors and new and emerging companies that may enter our existing or future markets. These companies may have similar or alternative products that are less costly or provide additional features. In addition, some of our significant suppliers, including Infineon Technology and Samsung Semiconductor, are also our competitors. These suppliers have the ability to manufacture competitive products at lower costs as a result of their higher levels of integration. Further, these suppliers may reduce the supply of memory chips available to the industry or us. We also face competition from current and prospective customers that evaluate our capabilities against the merits of manufacturing products internally. Competition also may arise due to the development of cooperative relationships among our current and potential competitors or third parties to increase the ability of their products to address the needs of our prospective customers. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

We compete in our target markets based primarily on quality, design and manufacturing technology, price and responsiveness to our customers needs. We expect our competitors will continue to improve the performance of their current products, reduce their current product sales prices and introduce new products that may offer greater performance and improved pricing, any of which could cause a decline in sales or loss of market acceptance of our products.

To remain competitive, we must, among other things:

Provide best-of-class design, manufacturing and test engineering services;

Maintain quality levels;

Provide technologically advanced products;

Successfully protect our intellectual property rights;

Accurately anticipate and prepare for new technological trends and standards in the industry;

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Compete favorably on the basis of price and sales and marketing incentives;

Offer flexible delivery schedules; and

Deliver finished products on a timely basis in sufficient volume to satisfy our customers requirements.

The memory, high-performance computing, networking and communications, consumer electronics and OEM markets are subject to rapid technological change, product obsolescence, frequent new product introductions and enhancements, changes in end-user requirements and evolving industry standards. Our ability to compete in these markets will depend in significant part upon our ability to successfully develop, introduce and sell new and enhanced products on a timely and cost-effective basis, and to respond to changing customer requirements.

Suppliers

IC devices represent more than 90% of the component costs of our manufactured Flash cards and DRAM modules. We purchase these IC devices from a small number of suppliers. In 2005, our significant suppliers of IC devices included:

Flash IC Device Suppliers	DRAM IC Device Suppliers
Samsung	Elpida
ST Microelectronics	Infineon Technologies
	Samsung

We are dependent on a small number of suppliers to supply Flash IC and DRAM IC devices. We have no long-term DRAM or Flash IC device supply contracts. We periodically review opportunities to develop alternative sources for our Flash IC and DRAM IC device needs. However, our options are very limited because of the small number of memory manufacturers. Our dependence on a small number of suppliers and the lack of any guaranteed sources of supply expose us to several risks, including the inability to obtain an adequate supply of components, price increases, late deliveries and poor component quality. Samsung and ST Microelectronics supply substantially all of the IC devices used in our Flash memory products. In addition, Elpida, Infineon Technologies and Samsung currently supply a majority of the DRAM IC devices used in our DRAM memory products. For risks associated with our supplier relationships, see Risk Factors Our dependence on a small number of suppliers for integrated circuit, or IC, devices and inability to obtain a sufficient supply of these components on a timely basis could harm our ability to fulfill orders.

Seasonality

In the past, our Consumer Division has been impacted by seasonal purchasing patterns resulting in lower sales generally in the first and second quarters and higher sales in the fourth quarter of each year. Other factors, including component price fluctuations, may distort the effect of seasonality. Our ability to adjust our short-term operating expenses in response to fluctuations in revenues is limited. As a result, should revenues decrease to a level lower than expected in any given period, our results of operations could be harmed.

Backlog

Sales of our memory products and storage solutions are made under short-term cancelable orders. We include in our backlog only those customer orders for which we have accepted purchase orders and to which we have assigned shipment dates within the upcoming six months. Since orders constituting our backlog are subject to change due to, among other things, customer cancellations and reschedulings, and our ability to procure necessary components, backlog is not necessarily an indication of future revenues. In addition, there can be no assurance that current backlog will necessarily lead to revenues in any future period. Our combined backlog was $13.3 million as of December 31, 2005 and $8.1 million as of December 31, 2004. Our Consumer Division backlog was $3.9 million as of December 31, 2005 and $2.1 million as of December 31, 2004. Our OEM Division backlog was $9.4 million as of December 31, 2005 and $6.0 million as of December 31, 2004. Our ability to predict future sales is limited because a majority of our quarterly product revenues come from orders that are received and fulfilled in the same quarter.

Intellectual Property Rights

We regard our patents, trademarks, trade secrets and other intellectual property as critical to our success. We rely on patents, trademarks, copyrights and trade secret laws, confidentiality procedures, and employee disclosure and invention assignment agreements to protect our intellectual property rights.

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As of March 1, 2006, we owned 16 U.S. patents, including U.S. Patents No. Re. 36,916 and No. 6,762,487 related to our stacking products, and 21 additional patent applications were pending. We have agreements to license certain of our intellectual property to third parties. In addition, we have entered into several licensing agreements to license the intellectual property of others. License fees related to the license of our intellectual property and our license of third party intellectual property were nominal for all periods presented in this report. Although we consider the patents currently held by us to be critical to our success, there can be no assurance that any patents currently held by us or any patents which may be granted to us in the future will not be challenged, invalidated or circumvented, or that rights granted thereunder will provide meaningful protection or other commercial advantage to us. There can be no assurance that third parties will not develop similar products, duplicate our products or design around the patents currently owned by us or which may be granted to us in the future. Because we view intellectual property rights as critical to our success, we intend to pursue future patents and other intellectual property rights in the U.S. There can be no assurance that we will be successful in these endeavors. In addition there can be no assurance that our trade secrets and know-how may not become known to third parties, or become part of the public domain, which in either case would harm our financial performance and business operations.

We have on at least one occasion applied for and may in the future apply for patent protection in foreign countries. The laws of foreign countries, however, may not adequately protect our intellectual property rights. Many U.S. companies have encountered substantial infringement problems in some foreign countries. Because we sell some of our products overseas, we have exposure to foreign intellectual property risks.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights. We believe that it may be necessary, from time to time, to initiate litigation against one or more third parties to preserve our intellectual property rights. In addition, from time to time, third parties may bring suits against us. For details regarding our pending intellectual property lawsuit, see Legal Proceedings and Risk Factors We are involved from time to time in claims and litigation over intellectual property rights, which may adversely affect our ability to manufacture and sell our products.

In the event of an adverse result in any such litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of certain products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes or obtain licenses to use infringed technology. Any litigation, whether as plaintiff or as defendant, would likely result in significant expense to us and divert the efforts of our technical and management personnel, whether or not such litigation is ultimately determined in our favor. In addition, the results of any litigation are inherently uncertain.

In the event we desire to incorporate third-party technology into our products or our products are found to infringe on others patents or intellectual property rights, we may be required to license such patents or intellectual property rights. If we obtain licenses from third parties, we may be required to pay license fees or make royalty payments, which could reduce our gross margins. If we are unable to obtain a license from a third party for technology, we could incur substantial liabilities or be required to expend substantial resources redesigning our products to eliminate the infringement. There can be no assurance that we would be successful in redesigning our products or that we could obtain licenses on commercially reasonable terms, if at all. In addition, any development or license negotiations could require substantial expenditures of time and other resources by us.

As is common in the industry, we currently have in effect a number of agreements in which we have agreed to defend, indemnify and hold harmless certain of our suppliers and customers from damages and costs which may arise from the infringement by our products of third-party patents, trademarks or other proprietary rights. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorneys fees. We may from time to time be engaged in litigation as a result of such indemnification obligations. In addition, our insurance does not cover intellectual property infringement.

In our efforts to maintain the confidentiality and ownership of trade secrets and other confidential information, all of our employees are required to sign employee non-disclosure and invention assignment agreements. This agreement requires our employees to disclose, document and assign their interest in all inventions, patents and copyrights developed while employed with us. Our employees further agree to preserve all of our confidential information including trade secrets, customer information, know-how and other business information. There can be no assurance that these agreements will provide meaningful protection of our trade secrets or other confidential information in the event of unauthorized use or disclosure of such information. See Risk Factors Our intellectual property may not be adequately protected, which could harm our competitive position.

Employees

As of December 31, 2005, we had 455 full-time employees, consisting of 230 in manufacturing (including test, quality assurance and material management), 136 in sales and marketing, 52 in finance and administration and 37 in design and product development. Our employees are not represented by any collective bargaining agreements and we have never experienced a work stoppage. Management believes that relations with our employees are satisfactory.

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Information Available on our Website

Our Internet address is www.simpletech.com. We make available on our website, free of charge, our filings made with the SEC electronically, including our reports on Form 10-K, Form 10-Q and Form 8-K, and any amendments to those filings. Copies are available as soon as reasonably practicable after we have filed or furnished these documents to the SEC. We have adopted a Code of Business Conduct and Ethics that applies to our employees (including our principal executive officer, chief financial officer and controller) and directors. A copy of our Code of Business Conduct and Ethics can be found under the Investor Relations section of our website. We may post amendments to or waivers of the provisions of the Code of Business Conduct and Ethics, if any, made with respect to any of our directors and executive officers on that website. The information on our website is not incorporated by reference in this Annual Report on Form 10-K.

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ITEM 1A. RISK FACTORS

Investing in our common stock involves a high degree of risk. Before purchasing our common stock, you should carefully consider the risks described below in addition to the other information in this Report. Our business, results of operations and financial condition may be materially and adversely affected due to any of the following risks. The risks described below are not the only ones we face. Additional risks we are not presently aware of or that we currently believe are immaterial may also impair our business operations. The trading price of our common stock could decline due to any of these risks, and you could lose all or part of your investment. In assessing these risks, you should also refer to the other information contained or incorporated by reference in this Report, including our consolidated financial statements and related notes.

This Report contains forward-looking statements based on the current expectations, assumptions, estimates and projections about our industry and us. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements as a result of certain factors, as more fully described in this section and elsewhere in this Report. We do not undertake to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

We expect our quarterly operating results to fluctuate in future periods, causing our stock price to fluctuate or decline.

Our quarterly operating results have fluctuated in the past, and we believe they will continue to do so in the future. Our future results of operations will depend on many factors including:

Our suppliers production levels for the components used in our products;

Our ability to procure required components or fluctuations in the cost of such components;

Fluctuating market demand for, and changes in the average sales prices of our products;

Changes in our customer and product revenue mix;

Our ability to successfully integrate any acquired businesses or assets;

Seasonal purchasing patterns for our Consumer Division products with lower sales generally occurring in the first and second quarters followed by higher sales in the fourth quarter of each year;

Market acceptance of new and enhanced versions of our products;

Expansion of our international business, including the opening of offices and facilities in foreign countries;

The timing of the introduction of new products or components and enhancements to existing products or components by us, our competitors or our suppliers;

Order cancellations, product returns, inventory write-downs, price protections, and rebates;

Manufacturing inefficiencies associated with the start-up of new products and volume production;

Expenses associated with strategic transactions, including acquisitions, joint ventures and capital investments;

Our ability to adequately support future rapid growth;

Our ability to absorb manufacturing overhead;

The effects of litigation;

Increases in our sales and marketing expenses in connection with decisions to pursue new product initiatives; and

Expenses associated with the start up of new operations or divisions.

Due to the above and other factors, quarterly revenues and results of operations are difficult to forecast, and period-to-period comparisons of our operating results may not be predictive of future performance. In one or more future quarters, our results of operations may fall below the expectations of securities analysts and investors. In that event, the trading price of our common stock would likely decline. In addition, the trading price of our common stock may fluctuate or decline regardless of our operating performance.

Our dependence on a small number of suppliers for integrated circuit, or IC, devices and inability to obtain a sufficient supply of these components on a timely basis could harm our ability to fulfill orders.

Typically, IC devices represent more than 90% of the component costs of our manufactured Flash cards and DRAM modules. We are dependent on a small number of suppliers that supply Flash and DRAM components. We have no long-term DRAM of Flash IC device supply contracts. Some of our competitors have entered into long-term contracts with suppliers that guarantee them a certain allocation of Flash IC devices. We have no assurance that our existing suppliers will agree to supply the quantities of Flash IC devices we may need to meet our production goals. We periodically review opportunities to develop alternative sources for our Flash and DRAM IC device needs. However, our options are very limited because of the small number of memory manufacturers. Our dependence on a small number of suppliers and the lack of any guaranteed

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sources of supply expose us to several risks, including the inability to obtain an adequate supply of components, price increases, late deliveries and poor component quality. Samsung and ST Microelectonics supply substantially all of the IC devices used in our Flash memory products. In addition, Elpida, Infineon Technologies and Samsung currently supply a majority of the DRAM IC devices used in our DRAM and IC Tower stacking DRAM memory products. A disruption in or termination of our supply relationship with any of these significant suppliers due to natural disasters or other factors, or our inability to develop relationships with new suppliers, if required, would cause delays, disruptions or reductions in product shipments or require product redesigns which could damage relationships with our customers and negatively affect our revenues and could increase our costs or the prices of our products. In particular, if our supply relationships with Elpida, Infineon Technologies, Samsung and ST Microelectonics are disrupted or terminated, our ability to manufacture and sell our DRAM and Flash products would be harmed and our business would be adversely affected.

Moreover, from time to time, our industry experiences shortages in Flash and DRAM IC devices which have driven up the price of those components and required some vendors to place their customers, ourselves included, on component allocation. This means that while we may have customer orders, we may not be able to obtain the materials that we need to fill those orders in a timely manner or at competitive prices. If we are unable to obtain Flash and DRAM IC devices at economical prices, our gross margins would decline unless we could raise the prices of our products in a commensurate manner or offset the cost increases elsewhere. In addition, if we are unable to obtain sufficient Flash IC devices and other components to meet our customers requirements, they may reduce future orders or eliminate us as a supplier and our revenues may decline. As a result, our reputation could be harmed, we may not be able to replace any lost business with new customers, and we may lose market share to our competitors.

Ineffective management of inventory levels or product mix, order cancellations, product returns, inventory write-downs, price protection and rebates could adversely affect our results of operations.

If we are unable to properly monitor, control and manage our inventory and maintain an appropriate level and mix of products with our customers, we may incur increased and unexpected costs associated with this inventory. For example, if our Consumer Division customers are unable to sell their inventory in a timely manner, we may choose or be required to lower the price of our products or allow our customers to exchange the slow-moving products for newer products. Similarly, if we manufacture products in anticipation of future demand that does not materialize, or if a customer cancels outstanding orders, we could experience an unanticipated increase in our inventory that we may be unable to sell in a timely manner, if at all. As a result, we could incur increased expenses associated with writing off excess or obsolete inventory. A majority of our sales through commercial channels include limited rights to return unsold inventory. In addition, while we may not be contractually obligated to accept returned products, we may determine that it is in our best interest to accept returns in order to maintain good relations with our customers. Product returns would increase our inventory and reduce our revenues. In addition, some of our inventory is shipped on a consignment basis, and we have very little ability to control or manage that inventory. Alternatively, we could end up with too little inventory and we may not be able to satisfy demand, which could have a material adverse effect on our customer relationships. Our risks related to inventory management are exacerbated by our strategy of closely matching inventory levels with product demand, leaving limited margin for error.

We have had to write-down inventory in the past for reasons such as obsolescence, excess quantities and declines in market value below our costs. These inventory write-downs were $1.4 million in 2005, $1.1 million in 2004 and $367,000 in 2003. In addition, we offer some of our Consumer Division customers limited price protection rights for inventories of our products held by them. If we reduce the list price of our products, these customers may receive credits from us. We incurred price protection charges of $779,000 in 2005, $854,000 in 2004 and $1.3 million in 2003. We also offer rebate programs through some of our Consumer Division customers to end-users. We incurred rebate charges of $806,000 in 2005, $298,000 in 2004 and $1.4 million 2003. Rebate charges increased significantly in 2005 compared to 2004 due primarily to the expansion of our revenues from the retail channel, which typically involves the frequent use of rebate programs. Price protection and rebate charges declined in 2004 compared to 2003 due primarily to a reduction of the number of customers that we offer price protection and rebate programs to as a result of our decision to reduce the sales of our Flash products into certain unprofitable sales channels.

We are also subject to repurchase agreements with various financial institutions in connection with wholesale inventory financing. Under these agreements, we may be required to repurchase inventory upon customer default with a financing institution and then resell the inventory through normal distribution channels. As of December 31, 2005, we have never been required to repurchase inventory in connection with the customer default agreements noted above. However, it may be possible that we will be required to repurchase inventory, upon customer default, in the future. Sales under such agreements were $1.3 million in 2005, $1.1 million in 2004 and $1.2 million in 2003.

We have no long-term volume commitments from our customers. Sales of our products are made through individual purchase orders and, in certain cases, are made under master agreements governing the terms and conditions of the relationships.

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Customers may change, cancel or delay orders with limited or no penalties. We have experienced cancellations of orders and fluctuations in order levels from period-to-period and we expect to continue to experience similar cancellations and fluctuations in the future, which could result in fluctuations in our revenues.

Declines in our average sales prices may result in declines in our revenues and gross profit.

Our industry is competitive and characterized by historical declines in average sales prices. From time to time, overcapacity in the DRAM memory component market has resulted in significant declines in component prices, which has negatively impacted our average sales prices, revenues and gross profit. During periods of overcapacity, our revenues and gross profit will decline if we do not increase unit sales of existing products or fail to introduce and sell new products in quantities sufficient to offset declines in sales prices. Any efforts to reduce costs and develop new products to offset the impact of further declines in average sales prices may not be successful. Declines in average sales prices would also enable OEMs to pre-install higher capacity base memory into new systems at existing price points, and thereby reduce the demand for our aftermarket memory products. Our competitors and customers also impose significant pricing pressures on us. Since a large percentage of our sales are to a small number of customers that are primarily retail consumer chains, distributors and large OEMs, these customers have exerted, and we expect they will continue to exert, pressure on us to make price concessions.

In addition, the continued transition to smaller design geometries and the use of 300 millimeter wafers by existing memory manufacturers could lead to a significant increase in the worldwide supply of DRAM and Flash components. Increases in the worldwide supply of DRAM and Flash components could also result from manufacturing capacity expansions. If not offset by increases in demand, these increases would likely lead to further declines in the average sales prices of our products and have a material adverse effect on our business and operating results. Furthermore, even if supply remains constant, if demand were to decrease, it would harm our average sales prices.

We are subject to the cyclical nature of the semiconductor industry and any future downturn could continue to adversely affect our business.

The semiconductor industry, including the memory markets in which we compete, is highly cyclical and characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry has experienced significant downturns often connected with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers products and declines in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average sales prices. Prior downturns in the semiconductor industry negatively impacted our average sales prices, revenues and earnings. Any future downturns could have a material adverse effect on our business and results of operations.

Sales to a limited number of customers represent a significant portion of our revenues, and the loss of any key customer would materially reduce our revenues.

Our dependence on a limited number of customers means that the loss of a major customer or any reduction in orders by a major customer would materially reduce our revenues. Historically, a relatively limited number of customers have accounted for a significant percentage of our revenues. Our ten largest customers accounted for an aggregate of 65.9% of our total revenues in 2005, 68.4% of our total revenues in 2004 and 51.9% of our total revenues in 2003. Our ten largest Consumer Division customers accounted for an aggregate of 61.8% of our Consumer Division revenues, or 31.6% of our total revenues, in 2005, 66.1% of our Consumer Division revenues, or 34.5% of our total revenues, in 2004 and 58.4% of our Consumer Division revenues, or 42.3% of our total revenues, in 2003. The following table sets forth certain information about each of our Consumer Division customers that accounted for more than 10.0% of our total revenues in 2005, 2004 and 2003.

	Year Ended December 31, 2005		Year Ended December 31, 2004		Year Ended December 31, 2003	
Consumer Division Customers	% of Total Revenues	% of Consumer Division Revenues	% of Total Revenues	% of Consumer Division Revenues	% of Total Revenues	% of Consumer Division Revenues
CDW Logistics, Inc. (formerly CDW Computer Centers)	15.0%	29.4%	17.9%	34.2%	19.2%	26.6%

Our ten largest OEM Division customers accounted for an aggregate of 85.1% of our OEM Division revenues, or 41.6% of our total revenues, in 2005, 85.9% of our OEM Division revenues, or 41.1% of our total revenues, in 2004 and 72.2% of our OEM Division revenues, or 19.9% of our total revenues, in 2003. The following table sets forth certain information about each of our OEM Division customers that accounted for more than 10.0% of our total revenues in 2005, 2004 and 2003.

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	Year Ended December 31, 2005		Year Ended December 31, 2004		Year Ended December 31, 2003	
OEM Division Customers	% of Total Revenues	% of OEM Division Revenues	% of Total Revenues	% of OEM Division Revenues	% of Total Revenues	% of OEM Division Revenues
Micron Semiconductor	14.2%	28.9%	21.3%	44.6%	*	*
Smart Modular	18.4%	37.6%	13.7%	29.8%	*	*

* Data not provided since customer represented less than 10% of total revenues.

Consolidation in some of our customers industries may result in increased customer concentration and the potential loss of customers as a result of acquisitions. In addition, the composition of our major customer base changes from quarter to quarter as the market demand for our customers products changes, and we expect this variability to continue in the future. We expect that sales of our products to a limited number of customers will continue to contribute materially to our revenues in the foreseeable future. The loss of, or a significant reduction in purchases by, any of our major customers could harm our business, financial condition and results of operations.

We may be less competitive if we fail to develop new and enhanced products and introduce them in a timely manner.

The memory, high-performance computing, networking and communications, consumer electronics and OEM markets are subject to rapid technological change, product obsolescence, frequent new product introductions and enhancements, changes in end-user requirements and evolving industry standards. Our ability to compete in these markets will depend in significant part upon our ability to successfully develop, introduce and sell new and enhanced products on a timely and cost-effective basis, and to respond to changing customer requirements.

We have experienced, and may in the future experience, delays in the development and introduction of new products. These delays would provide a competitor a first-to-market opportunity and allow a competitor to achieve greater market share. Our product development is inherently risky because it is difficult to foresee developments in technology, anticipate the adoption of new standards, coordinate our technical personnel, and identify and eliminate design flaws. Defects or errors found in our products after commencement of commercial shipments could result in delays in market acceptance of these products. New products, even if first introduced by us, may not gain market acceptance. Accordingly, there can be no assurance that our future product development efforts will result in future profitability or market acceptance. Lack of market acceptance for our new products will jeopardize our ability to recoup research and development expenditures, hurt our reputation and harm our business, financial condition and results of operations.

We may also seek to develop products with new standards for our industry. It will take time for these new standards and products to be adopted, for consumers to accept and transition to these new products and for significant sales to be generated from them, if this happens at all. Moreover, broad acceptance of new standards or products by consumers may reduce demand for our older products. If this decreased demand is not offset by increased demand for our new products, our results of operations could be harmed. We cannot assure you that any new products or standards we develop will be commercially successful.

Our efforts to expand our business internationally may not be successful and may expose us to additional risks that may not exist in the United States, which in turn could cause our business and operating results to suffer.

We sell our products to customers in foreign countries and seek to increase our level of international business activity through the expansion of our operations into select international markets, including Asia and Europe. Such strategy may include opening sales offices in foreign countries, the outsourcing of manufacturing operations to third party contract manufacturers, establishing joint ventures with foreign partners, and the establishment of manufacturing operations in foreign countries. Since the beginning of 2004, we have opened sales, marketing and engineering offices in the Netherlands, France, Hong Kong and Taiwan. Establishing operations in any other foreign country or region presents numerous risks, including:

- foreign laws and regulations, which may vary country by country, may impact how we conduct our business;
- higher costs of doing business in certain foreign countries, including different employment laws;

difficulty protecting our intellectual property rights from misappropriation or infringement;

difficulties and costs of staffing and managing operations in certain foreign countries;

political or economic instability;

changes in import/export duties;

necessity of obtaining government approvals;

trade restrictions;

work stoppages or other changes in labor conditions;

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difficulties in collecting of accounts receivables on a timely basis or at all;

taxes;

longer payment cycles and foreign currency fluctuations; and

seasonal reductions in business activity in some parts of the world, such as Europe.

In addition, changes in policies and/or laws of the United States or foreign governments resulting in, among other things, higher taxation, currency conversion limitations, restrictions on fund transfers or the expropriation of private enterprises, could reduce the anticipated benefits of our international expansion. We may also encounter potential adverse tax consequences if taxing authorities in different jurisdictions worldwide disagree with our interpretation of various tax laws or our determinations as to the income and expenses attributable to specific jurisdictions, which could result in our paying additional taxes, interest and penalties. Furthermore, any actions by countries in which we conduct business to reverse policies that encourage foreign trade or investment could adversely affect our business. If we fail to realize the anticipated revenue growth of our future international operations, our business and operating results could suffer.

We expect that our strategy to expand our international operations will require the expenditure of significant resources and involve the efforts and attention of our management. Unlike some of our competitors, we have limited experience operating our business in foreign countries. Some of our competitors may have substantial advantage over us in attracting customers in certain foreign countries due to earlier established operations in that country, greater knowledge with respect to cultural differences of customers residing in that country and greater brand recognition and longer-standing relationships with customers in that country. If our international expansion efforts in any foreign country are unsuccessful, we may decide to cease these foreign operations, which would likely harm our reputation and cause us to incur expenses and losses.

New accounting and financial reporting requirements, including new standards that affect how we account for equity compensation, may impact our financial results.

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. These principles are subject to interpretation by the Securities and Exchange Commission and various bodies formed to interpret and create appropriate accounting policies. A change in these policies could significantly impact our reported results and could retroactively affect previously reported transactions.

Historically, we have accounted for employee stock options and employee stock purchase plan shares for financial and accounting purposes under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees , which does not require the expensing of stock options until they are exercised. In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting No. 123(R), which amended financial accounting standards and require that awards under such plans be treated as compensation expense using the fair value method. On April 14, 2005, the U.S. Securities and Exchange Commission adopted a new rule amending the compliance dates for SFAS 123(R). In accordance with the new rule, the accounting provisions of SFAS 123(R) will be effective in fiscal 2006. We believe this revised standard will increase our compensation expense, could make our operating results less predictable and affect the way we compensate our employees or cause other changes in the way we conduct our business. For discussion of our employee stock option plan, see Note 11 to our consolidated financial statements Stock Option Plan .

Failure to maintain effective internal control over financial reporting could result in a negative market reaction.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we undertake a thorough examination of our internal control systems and procedures for financial reporting. We also are required to completely document and test those systems. Ultimately, our management will be responsible for assessing the effectiveness of our internal control over financial reporting, and our independent registered public accounting firm will be requested to attest to that report. We cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations since there is no precedent available by which to measure compliance adequacy.

Our filing of our annual report on a timely basis will depend upon our timely completion of these tasks. A late annual report could have material adverse effects on us, both legally and with respect to the opinions of the participants in the securities market.

If we identify one or more material weaknesses in our internal control over financial reporting, our management will be unable to assert such internal controls are effective. If we are unable to assert that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to attest that our management s report is fairly stated or they are unable to express an opinion on the effectiveness of our internal controls, it could result in a negative market reaction.

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Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq National Market rules, have required most public companies, including us, to devote additional internal and external resources to various governance and compliance matters. Because we have a relatively small corporate staff, we rely heavily on outside professional advisers to assist us with these efforts. As of December 31, 2005, we had incurred approximately $659,000 in connection with these efforts. Although we are uncertain about the total costs we will ultimately incur, we know they will at least be substantial. These costs will include increased accounting related fees associated with preparing the attestation report on our internal controls over financial reporting as required under Section 404 of the Sarbanes-Oxley Act of 2002. These new or changed laws, regulations and standards are subject to varying interpretations, as well as modifications by the government and Nasdaq. The way in which they are applied and implemented may change over time, which could result in even higher costs to address and implement revisions to compliance (including disclosure) and governance practices. We intend to invest the necessary resources to comply with evolving laws, regulations and standards. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed and we will be required to incur additional expenses.

We may make acquisitions that are dilutive to existing shareholders, result in unanticipated accounting charges or otherwise adversely affect our results of operations.

We intend to grow our business through business combinations or other acquisitions of businesses, products or technologies that allow us to complement our existing product offerings, expand our market coverage, increase our engineering workforce or enhance our technological capabilities. If we make any future acquisitions, we could issue stock that would dilute our shareholders percentage ownership, incur substantial debt, reduce our cash reserves or assume contingent liabilities.

Furthermore, acquisitions may require material infrequent charges and could result in adverse tax consequences, substantial depreciation, deferred compensation charges, in-process research and development charges, the amortization of amounts related to deferred compensation and identifiable purchased intangible assets or impairment of goodwill, any of which could negatively impact our results of operations.

Our limited experience in acquiring other businesses, product lines and technologies may make it difficult for us to overcome problems encountered in connection with any acquisitions we may undertake.

We continually evaluate and explore strategic opportunities as they arise, including business combinations, strategic partnerships, capital investments and the purchase, licensing or sale of assets. Our experience in acquiring other businesses, product lines and technologies is limited. The attention of our small management team may be diverted from our core business if we undertake any future acquisitions. Our recent acquisition of Memtech SSD, Corporation and any potential future acquisitions also involve numerous risks, including, among others:

- Problems and delays in successfully assimilating and integrating the purchased operations, personnel, technologies, products and information systems;
- Unanticipated costs and expenditures associated with the acquisition, including any need to infuse significant capital into the acquired operations;
- Adverse effects on existing business relationships with suppliers, customers and strategic partners;
- Risks associated with entering markets and foreign countries in which we have no or limited prior experience;
- Contractual, intellectual property or employment issues;

Potential loss of key employees of purchased organizations; and

Potential litigation arising from the acquired company s operations before the acquisition.

These risks could disrupt our ongoing business, distract our management and employees, harm our reputation and increase our expenses. Our inability to overcome problems encountered in connection with any acquisitions could divert the attention of management, utilize scarce corporate resources and otherwise harm our business. These challenges are magnified as the size of an acquisition increases, and we cannot assure you that we will realize the intended benefits of any acquisition. For example, in June 2004 we discontinued the operation of our Xiran Division, which was formed in 2002 as a result of our acquisition of the assets of Irvine Networks, LLC. The Xiran Division developed advanced board-level solutions that optimize server performance for networked storage applications, including IP storage. We were unable to successfully bring the Xiran Division products to market after funding its operations for over two years. In connection with the discontinued operation, we recorded a non-cash charge of approximately $3.0 million in the second quarter of 2004.

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We are unable to predict whether or when any prospective acquisition candidate will become available or the likelihood that any acquisition will be completed. Even if we do find suitable acquisition opportunities, we may not be able to consummate the acquisitions on commercially acceptable terms or realize the anticipated benefits of any acquisitions we do undertake.

Three of our beneficial shareholders have substantial influence over our operations and could control all matters requiring shareholder approval.

Manouch Moshayedi, Mike Moshayedi and Mark Moshayedi, each of whom is an executive officer and director of SimpleTech, are brothers and beneficially own approximately 63.4% of our outstanding common stock at December 31, 2005 (assuming the inclusion of shares of common stock subject to options that are presently exercisable or will become exercisable within 60 days of such date). In addition, they have a non-binding understanding that at any shareholders meeting of SimpleTech where action is to be taken with respect to the election of directors, they each would cause the shares of SimpleTech common stock beneficially owned by them to be voted in favor of their election as directors. As a result, they have the ability to control all matters requiring approval by our shareholders, including the election and removal of directors, approval of significant corporate transactions and the decision of whether a change in control will occur. This control could affect the price that certain investors may be willing to pay in the future for shares of our common stock.

We are involved from time to time in claims and litigation over intellectual property rights, which may adversely affect our ability to manufacture and sell our products.

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights. We believe that it may be necessary, from time to time, to initiate litigation against one or more third parties to preserve our intellectual property rights. Some of our suppliers and licensors have generally agreed to provide us with various levels of intellectual property indemnification for products and technology we purchase or license from them. A third-party could claim that our products, which incorporate the products purchased or technology licensed from our suppliers and licensors, infringes a patent or other proprietary right. In addition, from time to time, we have received, and may continue to receive in the future, notices that claim we have infringed upon, misappropriated or misused other parties proprietary rights. Any of the foregoing events or claims could result in litigation. Such litigation, whether as plaintiff or defendant, would likely result in significant expense to us and divert the efforts of our technical and management personnel, whether or not such litigation is ultimately determined in our favor. In the event of an adverse result in such litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of certain products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes or obtain licenses to use the infringed technology. In addition, our suppliers and licensors obligation to indemnify us for intellectual property infringement may be insufficient or inapplicable to any such litigation. A license may not be available on commercially reasonable terms, if at all. Our failure to obtain a license on commercially reasonable terms, or at all, could cause us to incur substantial costs and suspend manufacturing products using the infringed technology. If we obtain a license, we would likely be required to pay license fees or make royalty payments for sales under the license. Such payments would increase our costs of revenues and reduce our gross margins and gross profit. If we are unable to obtain a license from a third party for technology, we could incur substantial liabilities or be required to expend substantial resources redesigning our products to eliminate the infringement. There can be no assurance that we would be successful in redesigning our products or that we could obtain licenses on commercially reasonable terms, if at all. Product development or license negotiating would likely result in significant expense to us and divert the efforts of our technical and management personnel.

We are currently a party to one lawsuit regarding intellectual property as further described under Legal Proceedings. Because litigation is inherently uncertain, we cannot predict the outcome of this lawsuit. Although this lawsuit has been stayed pending the outcome of related lawsuits against other parties, we expect that if this lawsuit resumes, it is likely to divert the efforts and attention of our key management and technical personnel. In addition, we expect to incur substantial legal fees and expenses in connection with this lawsuit if it resumes. As a result, our defense of this lawsuit, regardless of its eventual outcome, is expected to be costly and time consuming.

Our indemnification obligations for the infringement by our products of the intellectual property rights of others could require us to pay substantial damages.

As is common in the industry, we currently have in effect a number of agreements in which we have agreed to defend, indemnify and hold harmless our customers and suppliers from damages and costs which may arise from the infringement by our products of third-party patents, trademarks or other proprietary rights. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorneys fees. Our insurance does not cover intellectual property infringement. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. We may periodically have to respond to claims and litigate these types of indemnification obligations. Any such indemnification claims could require us to pay substantial damages.

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Our indemnification obligations to our customers and suppliers for product defects could require us to pay substantial damages.

A number of our product sales and product purchase agreements provide that we will defend, indemnify and hold harmless our customers and suppliers from damages and costs which may arise from product warranty claims or claims for injury or damage resulting from defects in our products. We maintain insurance to protect against certain claims associated with the use of our products, but our insurance coverage may not be adequate to cover all or any part of the claims asserted against us. A successful claim brought against us that is in excess of, or excluded from, our insurance coverage could substantially harm our business, financial condition and results of operations.

Our intellectual property may not be adequately protected, which could harm our competitive position.

Our intellectual property is critical to our success. We protect our intellectual property rights through patents, trademarks, copyrights and trade secret laws, confidentiality procedures and employee disclosure and invention assignment agreements. It is possible that our efforts to protect our intellectual property rights may not:

Prevent the challenge, invalidation or circumvention of our existing patents;

Result in patents that lead to commercially viable products or provide competitive advantages for our products;

Prevent our competitors from independently developing similar products, duplicating our products or designing around the patents owned by us;

Prevent third-party patents from having an adverse effect on our ability to do business;

Provide adequate protection for our intellectual property rights;

Prevent disputes with third parties regarding ownership of our intellectual property rights;

Prevent disclosure of our trade secrets and know-how to third parties or into the public domain; and

Result in patents from any of our pending applications.

As part of our confidentiality procedures, we enter into non-disclosure and invention assignment agreements with all of our employees and attempt to control access to and distribution of our technology, documentation and other proprietary information. However, if such agreements are found to be unenforceable, we may be unable to adequately protect our intellectual property rights. In addition, despite these procedures, third parties could copy or otherwise obtain and make unauthorized use of our technologies or independently develop similar technologies.

In addition, if our IC Tower stacking patent is found to be invalid, our ability to exclude competitors from making, using or selling the same or similar products to our IC Tower stacking products would cease. We have on at least one occasion applied for and may in the future apply for patent protection in foreign countries. The laws of foreign countries, however, may not adequately protect our intellectual property rights. Many U.S. companies have encountered substantial infringement problems in foreign countries. Because we sell some of our products overseas, we have exposure to foreign intellectual property risks.

We may not be able to maintain or improve our competitive position because of the intense competition in the memory industry.

We conduct business in an industry characterized by intense competition, rapid technological change, evolving industry standards, declining average sales prices and rapid product obsolescence. Our primary competitors in the third-party memory module industry include: Crucial Memory, a division of Micron Technology, Kingston Technology, Lexar Media, M-Systems, PNY Technologies, SanDisk, and SMART Modular. Our competitors include many large domestic and international companies that have substantially greater financial, technical, marketing, distribution and other resources, broader product lines, lower cost structures, greater brand recognition and longer-standing relationships with customers and suppliers. As a result, our competitors may be able to respond better to new or emerging technologies or standards and to changes in customer requirements. Further, some of our competitors are in a better financial and marketing position from which to influence industry acceptance of a particular industry standard or competing technology than we are. Our competitors may also be able to devote greater resources to the development, promotion and sale of products, and may be able to deliver competitive products at a lower price.

We expect to face competition from existing competitors and new and emerging companies that may enter our existing or future markets with similar or alternative products, which may be less costly or provide additional features. In addition, some of our significant suppliers, including Infineon Technology and Samsung Semiconductor, are also our competitors, many of whom have the ability to manufacture competitive products at lower costs as a result of their higher levels of integration. We also face competition from current and prospective customers that evaluate our capabilities against the merits of manufacturing products internally. Competition may arise due to the development of cooperative relationships among our current and potential competitors or third parties to increase the ability of their products to address the needs of our prospective customers. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

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We expect our competitors will continue to improve the performance of their current products, reduce their prices and introduce new products that may offer greater performance and improved pricing, any of which could cause a decline in sales or loss of market acceptance of our products. In addition, our competitors may develop enhancements to, or future generations of, competitive products that may render our technology or products obsolete or uncompetitive.

The Flash-based storage market is constantly evolving, and we may not have rights to manufacture and sell certain types of products utilizing emerging new Flash formats, or we may be required to pay a royalty to sell products utilizing these formats.

The Flash-based storage market is constantly undergoing rapid technological change and evolving industry standards. Many consumer devices, such as digital cameras, PDAs and smartphones, may transition to emerging Flash memory formats, such as the xD Picture Card format, which we do not currently manufacture and do not have rights to manufacture. This will likely result in a decline in demand, on a relative basis, for other products that we manufacture such as CompactFlash, Secure Digital, Mini-SD and MultiMedia cards. If we decide to manufacture Flash products utilizing emerging formats, we will be required to secure licensing arrangements to give us the right to manufacture such products which may not be available at reasonable rates or at all. If we are not able to supply all Flash card formats at competitive prices or if we were to have product shortages, our revenues could be adversely impacted and our customers would likely cancel orders or seek other suppliers to replace us.

The execution of our growth strategy depends on our ability to retain key personnel, including our executive officers, and to attract qualified personnel.

Competition for employees in our industry is intense. We have had and may continue to have difficulty hiring the necessary engineering, sales and marketing and management personnel to support our growth. The successful implementation of our business model and growth strategy depends on the continued contributions of our senior management and other key research and development, sales and marketing and operations personnel, including Manouch Moshayedi, our Chief Executive Officer, Mike Moshayedi, our President, and Mark Moshayedi, our Chief Operating Officer, Chief Technical Officer and Secretary. In addition, as a result of our adoption of SFAS 123(R), we have begun to significantly reduce the use and quantity of stock options compared to the quantity of stock options we granted in recent years. We may be at a disadvantage in our ability to maintain and recruit qualified employees since many of the companies that compete with us for the same pool of qualified employees continue to offer stock options as part of their compensation package. We have experienced difficulties maintaining and attracting qualified employees as a result of our reduction in the use of stock options and we expect this difficulty to continue in the future unless we are able to develop other forms of incentive compensation to replace stock options. The loss of any key employee, the failure of any key employee to perform in his or her current position, or the inability of our officers and key employees to expand, train and manage our employee base would prevent us from executing our growth strategy.

We face risks associated with doing business in foreign countries, including foreign currency fluctuations and trade barriers, that could lead to a decrease in demand for our products or an increase in the cost of the components used in our products.

The volatility of general economic conditions and fluctuations in currency exchange rates affect the prices of our products and the prices of the components used in our products. International sales of our products accounted for 12.9%, 18.2% and 18.8% of our revenues in 2005, 2004 and 2003, respectively. Except for Europe, which accounted for 10.3% of our revenues in 2003, no other foreign geographic area or single foreign country accounted for more than 10.0% of our revenues in 2005, 2004 or 2003. For 2005, 2004 and 2003, more than 95.0% of our international sales were denominated in U.S. dollars. However, if there is a significant devaluation of the currency in a specific country, the prices of our products will increase relative to that country s currency and our products may be less competitive in that country. In addition, we cannot be sure that our international customers will continue to be willing to place orders denominated in U.S. dollars. If they do not, our revenues and results of operations will be subject to foreign exchange fluctuations, which could harm our business. We do not hedge against foreign currency exchange rate risks.

We purchase a majority of the DRAM and Flash components used in our products from local distributors of foreign suppliers. Although our purchases of DRAM and Flash components are currently denominated in U.S. dollars, devaluation of the U.S. dollar relative to the currency of a foreign supplier would likely result in an increase in our cost of DRAM and Flash components.

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Our international sales are subject to other risks, including regulatory risks, tariffs and other trade barriers, timing and availability of export licenses, political and economic instability, difficulties in accounts receivable collections, difficulties in managing distributors, lack of a significant local sales presence, difficulties in obtaining governmental approvals, compliance with a wide variety of complex foreign laws and treaties and potentially adverse tax consequences. In addition, the United States or foreign countries may implement quotas, duties, taxes or other charges or restrictions upon the importation or exportation of our products, leading to a reduction in sales and profitability in that country.

We have experienced quarterly and annual losses in the past and may continue to experience losses in the future.

Although we have been profitable for most of our history, we have experienced losses on a quarterly and annual basis in the past. In 2003 and in the second quarter of 2004, we incurred net losses of $1.6 million and $1.9 million, respectively. We have expended, and will continue to expend, substantial funds to pursue engineering, research and development projects, enhance sales and marketing efforts and otherwise operate our business. There can be no assurance that we will be profitable on a quarterly or annual basis in the future.

Disruption of our operations in our Santa Ana, California, manufacturing facilities would substantially harm our business.

Substantially all of our manufacturing operations is located in our facilities in Santa Ana, California. Due to this geographic concentration, a disruption of our manufacturing operations, resulting from sustained process abnormalities, human error, government intervention or natural disasters, including earthquakes, power failures, fires or floods, could cause us to cease or limit our manufacturing operations and consequently harm our business, financial condition and results of operations.

Our ability to use our tax credit carryforwards may be substantially limited, which could harm our financial condition.

In recent years, we have generated state tax credits, which we are not fully able to utilize at this time. The availability of some of these state tax credit carryforwards is subject to certain limitations. We had the following state credits as of December 31, 2005: research and development credit carryforwards of approximately $2.4 million, which carryforward indefinitely and enterprise zone credit carryforwards of approximately $1.9 million, which carryforward indefinitely. We periodically review our ability to use our tax credit carryforwards. Based on this periodic review, we may determine that the amount of tax credit carryforwards that can be utilized to offset future tax liabilities should be limited. Since a potential limitation is based on a number of factors, we cannot determine the impact of such a limitation at this time, but if our ability to use tax credit carryforwards were substantially limited, it could harm our financial condition.

Compliance with environmental laws and regulations could harm our operating results.

We are subject to a variety of environmental laws and regulations governing, among other things, air emissions, waste water discharge, waste storage, treatment and disposal, and remediation of releases of hazardous materials. Our failure to comply with present and future requirements could harm our ability to continue manufacturing our products. Such requirements could require us to acquire costly equipment or to incur other significant expenses to comply with environmental regulations. The imposition of additional or more stringent environmental requirements, the results of future testing at our facilities, or a determination that we are potentially responsible for remediation at other sites where problems are not presently known to us, could result in expenses in excess of amounts currently estimated to be required for such matters.

Failure to comply with governmental laws and regulations could harm our business.

Our business is subject to regulation by various federal and state governmental agencies. Such regulation includes the radio frequency emission regulatory activities of the Federal Communications Commission, the anti-trust regulatory activities of the Federal Trade Commission and Department of Justice, the consumer protection laws of the Federal Trade Commission, the import/export regulatory activities of the Department of Commerce, the product safety regulatory activities of the Consumer Products Safety Commission, the regulatory activities of the Occupational Safety and Health Administration, the environmental regulatory activities of the Environmental Protection Agency, the labor regulatory activities of the Equal Employment Opportunity Commission and tax and other regulations by a variety of regulatory authorities in each of the areas in which we conduct business. We are also subject to regulation in other countries where we conduct business. In certain jurisdictions, such regulatory requirements may be more stringent than in the United States. We are also subject to a variety of federal and state employment and labors laws and regulations, including the Americans with Disabilities Act, the Federal Fair Labor Standards Act, the WARN Act and other regulations related to working conditions, wage-hour pay, over-time pay, employee benefits, anti-discrimination, and termination of employment.

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Noncompliance with applicable regulations or requirements could subject us to investigations, sanctions, mandatory product recalls, enforcement actions, disgorgement of profits, fines, damages, civil and criminal penalties, or injunctions. In addition from time to time we have received, and expect to continue to receive, correspondence from former employees terminated by us who threaten to bring claims against us alleging that we have violated one or more labor and employment regulations. In certain of these instances the former employee has brought claims against us and we expect that we will encounter similar actions against us in the future. An adverse outcome in any such litigation could require us to pay contractual damages, compensatory damages, punitive damages, attorneys fees and costs.

These enforcement actions could harm our business, financial condition, results of operations and cash flows. If any governmental sanctions are imposed, or if we do not prevail in any possible civil or criminal litigation, our business, financial condition, results of operations and cash flows could be materially adversely affected. In addition, responding to any action will likely result in a significant diversion of management s attention and resources and an increase in professional fees.

Our stock price is likely to be volatile and could drop unexpectedly.

Our common stock has been publicly traded since September 2000. The market price of our common stock has been subject to significant fluctuations since the date of our initial public offering. The stock market has from time to time experienced significant price and volume fluctuations that have affected the market prices of securities, particularly securities of technology companies. As a result, the market price of our common stock may materially decline, regardless of our operating performance. In the past, following periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. We may become involved in this type of litigation in the future. Litigation of this type is often expensive and diverts management s attention and resources.

Anti-takeover provisions in our charter documents and stock option plan could prevent or delay a change in control and, as a result, negatively impact our shareholders.

We have taken a number of actions that could have the effect of discouraging a takeover attempt. For example, provisions of our amended and restated articles of incorporation and amended and restated bylaws could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. These provisions also could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

These provisions include:

- limitations on who may call special meetings of shareholders;
- advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by shareholders at shareholder meetings;
- elimination of cumulative voting in the election of directors;
- the right of a majority of directors in office to fill vacancies on the board of directors;
- the ability of our board of directors to issue, without shareholder approval, blank check preferred stock to increase the number of outstanding shares and thwart a takeover attempt.

Provisions of our 2000 Stock Incentive Plan allow for the automatic vesting of all outstanding options granted under the 2000 Stock Incentive Plan upon a change in control under certain circumstances. Such provisions may have the effect of discouraging a third party from acquiring us, even if doing so would be beneficial to our shareholders.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We occupy two leased facilities of approximately 24,500 and 48,600 square feet in Santa Ana, California, which serve as our corporate headquarters. In addition to our executive offices, these facilities also contain substantially all of our manufacturing, engineering, research and development and testing operations. We lease the 24,500 square foot facility from MDC Land LLC, a limited liability company owned by Manouch Moshayedi, Mike Moshayedi and Mark Moshayedi, each of whom is an executive officer, director and major shareholder of SimpleTech. The base rent was approximately $17,000 per month through July 31, 2005. Effective August 1, 2005, the base rent was adjusted to approximately $18,000 per month as a result of an appraisal of the current market value performed as required by the lease. This lease expires in July 2017. Beginning August 1, 2007, and for the remainder of the lease, base rent shall be adjusted every two years based on the change in the Consumer Price Index.

We also lease the 48,600 square foot facility from MDC Land LLC. The base rent was approximately $33,000 per month through July 31, 2005. Effective August 1, 2005, the base rent was adjusted to approximately $32,000 per month as a result of an appraisal of the current market value as required by the lease. This lease also expires in July 2017. Beginning August 1, 2007, and for the remainder of the lease, base rent shall be adjusted every two years based on the change in the Consumer Price Index.

We also lease a number of small facilities in both foreign and domestic locations for our additional sales, research and development and engineering staff and for storage. We believe that our existing leased space is adequate for our current operations and that suitable replacement and additional spaces will be available in the future on commercially reasonable terms.

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ITEM 3. LEGAL PROCEEDINGS

Lemelson Medical, Education & Research Foundation, LLP Patent Infringement

We received notice on November 26, 2001, that the Lemelson Medical, Education & Research Foundation, LLP filed a complaint on November 13, 2001, against us and other defendants. The complaint was filed in the District Court of Arizona and alleges that our manufacturing processes infringe several patents that the Lemelson Foundation allegedly owns. The complaint also states that these allegedly infringed patents relate to machine vision technology and bar coding technology. On March 7, 2002, we were served with the Lemelson Foundation complaint. Thereafter, the case was stayed pending the outcome of related cases against parties involving the same patents. On September 9, 2005, in one of these related cases, the U.S. Court of Appeals for the Federal Circuit affirmed a decision by the U.S. District Court for the District of Nevada that found several Lemelson Foundation patents to be unenforceable. Because the final outcome of the related cases are expected to affect the Lemelson Foundation s lawsuit against us, an estimate of potential damages, if any, would be premature and speculative. We believe this lawsuit is without merit and we intend to vigorously defend ourselves against it.

We are not currently involved in any other material legal proceedings. We are not aware of any other material legal proceedings threatened or pending against us. However, we are involved in other suits and claims arising in the ordinary course of business, and we may from time to time become a party to other legal proceedings arising in the ordinary course of business, including, but not limited to, employee, customer and vendor disputes. In addition, in the past we have received, and we may continue to receive in the future, claims alleging infringement of patent or other intellectual property rights. Our management believes that these claims generally are without merit and intend to contest them vigorously.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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PART II.

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is traded on The Nasdaq National Market under the symbol STEC. The following table sets forth the range of high and low intra-day sales prices reported on The Nasdaq National Market for our common stock for the periods indicated. Such quotations represent inter-dealer prices without retail markup, markdown or commission and may not necessarily represent actual transactions.

	Price range of Common Stock	
	High	Low
Year Ended December 31, 2005:		
First Quarter	$ 4.87	$ 3.70
Second Quarter	$ 4.16	$ 3.27
Third Quarter	$ 5.02	$ 3.70
Fourth Quarter	$ 5.22	$ 3.42
Year Ended December 31, 2004:		
First Quarter	$ 6.99	$ 4.22
Second Quarter	$ 5.90	$ 3.22
Third Quarter	$ 4.18	$ 2.76
Fourth Quarter	$ 5.51	$ 3.56

Recent Share Prices

The following table sets forth the closing sales prices per share of our common stock on The Nasdaq National Market on December 30, 2005, the last trading day in 2005, and March 1, 2006. Because the market price of our common stock is subject to fluctuation, the market value of the shares of our common stock may increase or decrease.

	Closing Price
December 30, 2005	$ 3.77
March 1, 2006	$ 4.14

Holders

As of March 1, 2006, there were 55 holders of record of our common stock.

Dividend Policy

We were originally incorporated as an S corporation in March 1990 and converted to a C corporation in September 2000. Since becoming a C corporation, we have not declared or paid any cash dividends on our common stock and do not expect to do so in the foreseeable future. We currently intend to retain all available funds for use in the operation and expansion of our business. Any future determination to pay dividends will be at the discretion of our board of directors and will depend principally upon our results of operations, financial conditions, capital requirements, contractual and legal restrictions and other factors the board deems relevant.

Recent Sales of Unregistered Securities

None

Use of Proceeds from Sales of Registered Securities

On October 4, 2000, we completed our initial public offering of our common stock pursuant to our Registration Statement on Form S-1 (File No. 333-32478) that was declared effective by the Securities and Exchange Commission on September 28, 2000. There has been no material change with respect to our use of the net proceeds from our initial public offering to the information discussed in our Annual Report on Form 10-K for the year ended December 31, 2000. We continue to invest the

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remaining net proceeds in short-term, interest-bearing instruments, pending their use to fund working capital and other general corporate purposes, including expansion of sales and marketing activities, enhancement of our technology, possible acquisitions and international expansion.

Equity Compensation Plan Information

The equity compensation plan information required by this Item is set forth in Part III, Item 12 of this Annual Report on Form 10-K.

Issuer Purchases of Equity Securities

We did not repurchase any shares of our common stock during the three months ended December 31, 2005. In June 2004 our board of directors authorized a share repurchase program enabling us to repurchase up to $15 million of our common stock over an 18-month period expiring on December 16, 2005. During the term of the share repurchase program, we repurchased 3,045,886 shares of common stock at an average share price of $3.88, including commissions, in 2005 and 841,509 shares of common stock at an average share price of $3.68, including commissions, in 2004. The share repurchase plan expired on December 16, 2005. Repurchased shares were returned to the status of authorized but unissued shares of common stock and may be issued by us in the future.

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ITEM 6. SELECTED FINANCIAL DATA

You should read the following selected consolidated financial data in conjunction with our consolidated financial statements and related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this Report. The consolidated statement of operations data for each of the three years in the period ended December 31, 2005 and the consolidated balance sheet data at December 31, 2005 and 2004 were derived from our consolidated financial statements that have been audited by our independent registered public accounting firm, and are included elsewhere in this Report. The consolidated statement of operations data for the years ended December 31, 2002 and 2001 and the consolidated balance sheet data at December 31, 2003, 2002 and 2001 were derived from our audited consolidated financial statements and are not included in this Report.

	Year Ended December 31,				
	2005	2004	2003	2002	2001
	(in thousands, except share and per share amounts)				
Consolidated Statement of Operations Data:					
Net revenues	$ 261,988	$ 275,432	$ 211,806	$ 176,531	$ 164,241
Cost of revenues	212,887	228,269	175,927	143,582	127,832
Gross profit	49,101	47,163	35,879	32,949	36,409
Sales and marketing	24,179	19,875	18,787	17,527	18,078
General and administrative	12,705	10,106	10,077	10,328	11,262
Research and development	6,560	4,295	2,445	2,762	4,297
Total operating expenses	43,444	34,276	31,309	30,617	33,637
Operating income	5,657	12,887	4,570	2,332	2,772
Interest income, net	1,629	1,052	557	778	1,395
Income from continuing operations before provision for income taxes	7,286	13,939	5,127	3,110	4,167
Provision (benefit) for income taxes	1,713	5,158	1,645	(188)	1,655
Income from continuing operations	$ 5,573	$ 8,781	$ 3,482	$ 3,298	$ 2,512
Loss from discontinued operations before benefit for income taxes		(7,115)	$ (8,728)	$ (8,196)	
Benefit for income taxes		(3,023)	$ (3,598)	$ (3,507)	
Loss from discontinued operations		$ (4,092)	$ (5,130)	$ (4,689)	
Net income (loss)	$ 5,573	$ 4,689	$ (1,648)	$ (1,391)	$ 2,512
Net income (loss) per share:					
Basic:					
Continuing operations	$ 0.12	$ 0.18	$ 0.09	$ 0.08	$ 0.07
Discontinued operations		$ (0.08)	$ (0.13)	$ (0.12)	
Total	$ 0.12	$ 0.10	$ (0.04)	$ (0.04)	$ 0.07
Diluted:					
Continuing operations	$ 0.12	$ 0.17	$ 0.08	$ 0.08	$ 0.06
Discontinued operations		$ (0.08)	$ (0.12)	$ (0.11)	

Total	$ 0.12	$ 0.09	$ (0.04)	$ (0.03)	$ 0.06
Shares used in computation of net income (loss) per share:					
Basic	45,243,141	47,707,365	40,408,610	38,515,825	38,126,687
Diluted	46,624,517	49,563,208	42,559,586	40,336,008	39,435,505

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	2005	2004	December 31, 2003	2002	2001
			(in thousands)		
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 60,006	$ 73,346	$ 30,769	$ 24,442	$ 51,831
Marketable securities		9,972	45,625	19,530	
Working capital	114,534	121,564	114,112	60,681	64,733
Total assets	155,141	153,409	153,669	94,240	89,114
Long-term portion of debt and capital lease obligations					384
Total shareholders equity	127,382	131,428	128,324	73,902	74,045

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

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes to such consolidated financial statements included elsewhere in this Report beginning on page F-1. The following discussion contains forward-looking statements that involve risks and uncertainties. Investors should not place undue reliance on these forward-looking statements. These forward-looking statements are based on current expectations and actual results could differ materially from those discussed herein. Factors that could cause or contribute to the differences are discussed in Business Risk Factors and elsewhere in this Report. Our actual results could differ materially from those predicted in these forward-looking statements, and the events anticipated in the forward-looking statements may not actually occur. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this Report to conform these statements to actual results or to reflect the occurrence of unanticipated events, unless required by law.

Overview

SimpleTech, Inc. designs, develops, manufactures and markets custom and open-standard memory solutions based on Flash memory and DRAM technologies and external storage solutions. Headquartered in Santa Ana, California, we specialize in developing high-density DRAM memory modules and high-speed, high-capacity solid-state Flash drives and memory cards used in sensitive and highly-volatile environments.

We sell our products through our Consumer and OEM Divisions. Our Consumer Division sells our products through a variety of distribution channels, including VARs, mail order, distributors, and mass market retailers. Our OEM Division markets our products to OEMs, leveraging our custom design capabilities to offer custom memory solutions to address their specific needs.

We are focusing on several revenue growth initiatives, including:

Developing and qualifying customized OEM Flash-based products, including our Zeus product line, for industrial applications;

Targeting new customers for our value-add OEM DRAM memory solutions;

Increasing retail sales of our storage product line; and

Expanding our international OEM business in Asia and Europe.

Over the past several years we have expanded our custom design capabilities of Flash products for OEM applications and invested significantly in industrial-grade controller technology. OEM Flash product revenue increased 12% from $20.1 million in 2003 to $22.6 million in 2004, and increased 66% from 2004 to $37.6 million in 2005. We expect our continued investments in OEM Flash controller development to result in continued revenue growth from our OEM Flash product line in 2006 and beyond. OEM Flash product gross margins are typically significantly higher than our Consumer Flash product gross margins and were our highest gross margin product line in 2005.

We offer monolithic DRAM memory modules and DRAM memory modules based on our stacking technology. Prior to 2005, a substantial portion of our OEM DRAM business had been comprised of stacked DRAM memory modules. As a result of the introduction of new DRAM technologies, we expect that a higher percentage of our OEM DRAM business will be derived from monolithic DRAM memory modules. During 2005, we faced transitional challenges as some of our OEM DRAM customers transitioned from modules based on PC 2100 to PC 2700 and from DDR I to DDR II technologies. Our OEM monolithic and stacked DRAM memory module revenue decreased from $107.7 million in 2004 to $90.0 million in 2005. We plan to introduce DRAM components utilizing our next generation Postage Stamp stacking technology, based on the latest generation BGA components, in the first half of 2006. We expect our OEM stacked DRAM memory module business to remain difficult to project for the next several quarters as our customers continue to qualify the latest generation modules.

In the past year, we have invested significantly in the design, development and launch of our SimpleShare product line of network attached storage, or NAS, external drives. During 2005, we initiated external drive launches into numerous major U.S. retailers and external storage drive revenue increased 32% from $10.9 million in 2003 to $14.4 million in 2004, and increased 144% from 2004 to $35.2 million in 2005. We expect

to continue to grow our external storage drive business in 2006.

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During 2005, we opened a logistics and purchasing office in Hong Kong and a research and development office in Taiwan. As part of our continuing effort to expand our international OEM business, we plan to open an OEM sales office in Japan in 2006.

We do not expect continued pursuit of these growth initiatives to have a material impact on our quarterly general and administrative expenses in 2006 compared to our recent quarterly run rates. However, if revenues increase due to the execution of these initiatives, we expect related increases in sales and marketing expenses.

During 2005, we also expanded our OEM Flash business through our acquisition on July 13, 2005 of Memtech SSD, Corporation, a provider of ultra-rugged and reliable solid state Flash drives. The acquisition highlighted our continuing commitment to the OEM Flash market and enabled us to create one of the most comprehensive offerings of solid state drives and other Flash-based solutions for industrial and military applications.

On December 19, 2005, our board of directors terminated our Employee Stock Purchase Plan, or ESPP, and approved the acceleration of the vesting of all then current unvested stock options awarded under our 2000 Stock Incentive Plan, including options held by our consultants, employees, officers and directors. As a result of this action, stock options to purchase approximately 5.6 million shares of common stock became exercisable effective December 19, 2005, representing approximately 56% of our total current outstanding stock options as of such date. All other terms and conditions applicable to such stock options, including the exercise prices, remain unchanged. The decision to terminate the ESPP and accelerate vesting of the stock options was made primarily to avoid recognizing the related compensation expense in our future consolidated financial statements with respect to the shares issued under the ESPP and the unvested stock options upon our adoption of Statement of Financial Accounting Standards, or SFAS, No. 123(R), Share-Based Payment, on January 1, 2006. We had no unvested stock options at December 31, 2005. It is anticipated that the accelerated vesting of these stock options will eliminate potential pre-tax compensation expense recognition in future periods beginning January 1, 2006 of approximately $9.4 million, of which approximately $3.8 million would have been incurred during the year ending December 31, 2006. Based upon the December 19, 2005 closing price of our common stock on the Nasdaq National Market of $3.79 per share, our historical employee turnover rates and estimate of future employee separation, this action resulted in a non-cash stock compensation expense of $374,000 in the fourth quarter of 2005. As a result of our adoption of SFAS 123(R), we have begun to significantly reduce the use and quantity of stock options compared to the quantity of stock options we granted in recent years. Note 2 to our consolidated financial statements provides our pro forma net income and earnings per share as if we had used a fair-value-based method similar to the methods required under SFAS 123(R) to measure the compensation expense for employee stock awards during the years ended December 31, 2005, 2004 and 2003.

Gross profit as a percentage of revenues for our OEM Division is typically higher than our Consumer Division. We track revenues and gross margins for our Consumer and OEM Divisions. We do not track separately, and do not intend to track separately, operating expenses for our Consumer and OEM Divisions.

Historically, a limited number of customers have accounted for a significant percentage of our revenue. Our ten largest customers accounted for an aggregate of 65.9%, 68.4% and 51.9% of our total revenues in 2005, 2004 and 2003, respectively. Smart Modular, Micron Semiconductor and CDW accounted for 18.4%, 15.0% and 15.0%, respectively, of our total revenues in 2005. Smart Modular, Micron Semiconductor and CDW accounted for 13.7%, 21.3% and 17.9%, respectively, of our total revenues in 2004. CDW accounted for an aggregate of 19.2% of our total revenues in 2003. Other than Smart Modular, Mircon Semiconductor and CDW, no other customer accounted for more than 10.0% of our total revenues in 2005, 2004 or 2003. The composition of our major customer base changes from quarter to quarter as the market demand for our products changes, and we expect this variability will continue in the future. We expect that sales of our products to a limited number of customers will continue to account for a majority of our revenues in the foreseeable future. The loss of, or a significant reduction in purchases by any of our major customers, would harm our business, financial condition and results of operations. See Risk Factors Sales to a limited number of customers represent a significant portion of our revenues, and the loss of any key customer would materially reduce our revenues.

International sales of our products accounted for 12.9%, 18.2% and 18.8% of our total revenues in 2005, 2004 and 2003, respectively. In 2003, Europe accounted for 10.3%, of our total revenues. No other foreign geographic area or single foreign country accounted for more than 10.0% of our total revenues in 2005, 2004 and 2003. For 2005, 2004 and 2003, more than 95.0% of our international sales were denominated in U.S. dollars. In addition, our purchases of DRAM and Flash components are currently denominated in U.S. dollars. However, we do face risks associated with doing business in foreign countries. See Risk Factors We face risks associated with doing business in foreign countries, including foreign currency fluctuations and trade barriers, that could lead to a decrease in demand for our products or an increase in the cost of the components used in our products.

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In the past, we have been, and expect to continue to be, impacted by seasonal purchasing patterns resulting in lower sales in the first and second quarters of each year. Other factors, including component price fluctuations, may distort the effect of seasonality. Our ability to adjust our short-term operating expenses in response to fluctuations in revenues is limited. As a result, should revenues decrease to a level lower than expected in any given period, our results of operations would be harmed.

Discontinued Operations of Xiran Division

In June 2004, we discontinued the operation of our Xiran Division, which was formed in 2002 as a result of our acquisition of the assets of Irvine Networks, LLC. The Xiran Division developed advanced board-level solutions that optimized server performance for networked storage applications, including IP storage. In 2004, the discontinued Xiran Division recorded a $7.1 million operating loss before benefit for income taxes. In addition, we took a pre-tax charge of approximately $3.0 million that included a $1.5 million write-off of inventory, an $802,000 write-off reflecting the net book value of Xiran Division fixed assets that will no longer be used, a $310,000 write-off of the net book value of the intangible asset recorded at the date of acquisition, a $173,000 lease impairment charge related to the Xiran Division office space that will no longer be used, $102,000 in severance costs of Xiran Division employees who are no longer employed by us, and approximately $51,000 in other charges. Monthly rent on the Xiran Division office lease, which expired on June 30, 2005, was approximately $22,000. In calculating the lease impairment charge, we reduced the total lease liability by the estimated fair market value of sublease rental income. The closure of the Xiran Division had no impact on net revenues, gross profit or net income in 2005. Our consolidated financial statements have been reclassified to reflect the Xiran Division as a discontinued operation for all prior periods presented.

Results of Operations

The following table sets forth, for the periods indicated, certain consolidated statement of operations data reflected as a percentage of revenues. In June 2004, we discontinued the operation of our Xiran Division. The table below does not include the revenues and operating expenses of our Xiran division, which is presented as discontinued operations.

	2005	2004	2003
Net revenues	100.0 %	100.0 %	100.0 %
Cost of revenues	81.3	82.9	83.1
Gross profit	18.7	17.1	16.9
Operating expenses			
Sales and marketing	9.2	7.2	8.9
General and administrative	4.8	3.7	4.8
Research and development	2.5	1.5	1.1
Total operating expenses	16.5	12.4	14.8
Operating income	2.2	4.7	2.1
Interest income	0.6	0.4	0.3
Income before provision for income taxes	2.8	5.1	2.4

Comparison of the years ended December 31, 2005 and 2004

Net Revenues. Our revenues decreased 4.9% from $275.4 million in 2004 to $262.0 million in 2005. Sales of memory products accounted for 86.3% of our revenues in 2005, compared to 94.3% of our revenues in 2004. The decrease in revenues from 2004 to 2005 was due primarily to a 27% decrease in our average sales price from $79 in 2004 to $58 in 2005, partially offset by a 29% increase in units shipped from 3.5 million units in 2004 to 4.5 million units in 2005. The decrease in average sales price resulted primarily from a shift in product mix toward lower capacity products. The increase in unit volume resulted primarily from unit volume increases of 93% for external storage products, 59% for Flash products and 1% for standard memory products, partially offset by a unit volume decrease of 21% for IC Tower stacking products. The mix of products sold varies from quarter to quarter and may vary in the future, affecting our overall average sales price and gross margin.

Our OEM Division revenues decreased 2.6% from $131.7 million in 2004 to $128.3 million in 2005. The decrease in OEM Division revenues was due primarily to a 43% decrease in average sales price from $143 in 2004 to $82 in 2005, partially offset by a 74% increase in OEM Division units shipped from 918,000 units in 2004 to 1.6 million units in 2005. The decrease in OEM Division average sales price resulted

primarily from a shift in product mix from higher capacity, higher average sales price products, such as our stacking products which declined in units shipped by 22% from 2004 to 2005, toward lower capacity, lower average sales price products, such as our Flash products which increased in units shipped by 203% from 2004 to 2005.

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Consumer Division revenues decreased 7.0% from $143.7 million in 2004 to $133.7 million in 2005. The decrease in Consumer Division revenues was due primarily to a 20% decrease in average sales price from $56 in 2004 to $45 in 2005, partially offset by a 20% increase in units shipped from 2.5 million units in 2004 to 3.0 million units in 2005. Consumer Division Flash products accounted for approximately 74% of the 405,000 increase in units shipped from 2004 to 2005. The decrease in average sales price resulted primarily from this shift in product mix toward Consumer Division Flash products, which is our lowest capacity, lowest average sales price Consumer Division product line.

Our combined backlog was $13.3 million as of December 31, 2005, compared to $8.1 million as of December 31, 2004. Our OEM Division backlog was $9.4 million as of December 31, 2005, compared to $6.0 million as of December 31, 2004. Our Consumer Division backlog was $3.9 million as of December 31, 2005, compared to $2.1 million as of December 31, 2004. Since orders constituting our backlog are subject to change due to, among other things, customer cancellations and reschedulings, and our ability to procure necessary components, backlog is not necessarily an indication of future revenues.

Gross Profit. Our gross profit increased 4.0% from $47.2 million in 2004 to $49.1 million in 2005. Gross profit as a percentage of revenues increased from 17.1% in 2004 to 18.7% in 2005 due primarily to a shift in product mix toward higher margin OEM Division product lines. Gross profit as a percentage of revenues for our OEM Division increased from 19.4% in 2004 to 24.2% in 2005 due primarily to a significant shift in product mix toward our Flash product line, which is our highest margin OEM Division product line. OEM Division Flash units shipped increased 203% from 308,000 units in 2004 to 933,000 units in 2005. Gross profit as a percentage of revenues for our Consumer Division decreased from 15.0% in 2004 to 13.5% in 2005 due primarily to a shift in product mix toward our Flash product line, which is our lowest margin Consumer Division product line. Consumer Division Flash units shipped increased 23% from 1.3 million units in 2004 to 1.6 million units in 2005. As a result of our OEM Division selling a larger percentage of higher margin, higher capacity DRAM, Flash memory and IC Tower stacking products, gross profit as a percentage of revenues for our OEM Division is typically higher than our Consumer Division.

Sales and Marketing. Sales and marketing expenses are comprised primarily of personnel costs and travel expenses for our domestic and international sales and marketing employees, commissions paid to internal salespersons and independent manufacturers representatives, shipping costs and marketing programs. Sales and marketing expenses increased from $19.9 million in 2004 to $24.2 million in 2005. Sales and marketing expenses as a percentage of revenues increased from 7.2% in 2004 to 9.2% in 2005. Sales and marketing expenses increased due primarily to increased personnel to support our expanding retail external storage and OEM Flash business units. Sales and marketing headcount increased from 106 employees at December 31, 2004 to 136 employees at December 31, 2005. Sales and marketing payroll and related benefits increased by approximately $3.0 million from 2004 to 2005.

General and Administrative. General and administrative expenses are comprised primarily of personnel costs for our executive and administrative employees, professional fees and facilities overhead. General and administrative expenses increased from $10.1 million in 2004 to $12.7 million in 2005. General and administrative expenses as a percentage of revenues increased from 3.7% in 2004 to 4.8% in 2005 due primarily to increases in payroll of $718,000, accounting and audit costs, including Sarbanes-Oxley implementation costs, of $384,000 and other administrative expenses including legal fees, amortization expense, insurance, corporate tax planning and office supplies, of $734,000.

Research and Development. Research and development expenses are comprised primarily of personnel costs for our engineering and design staff and the cost of prototype supplies. Research and development expenses increased from $4.3 million in 2004 to $6.6 million in 2005. Research and development expenses as a percentage of revenues increased from 1.5% in 2004 to 2.5% in 2005. Research and development expenses increased from 2004 to 2005 due primarily to our increased investment in the development of industrial grade Flash controllers and expansion of our NAS external storage drive product line.

Interest Income. Interest income is comprised primarily of interest income from our cash, cash equivalents and marketable securities. Interest income was $1.1 million in 2004 compared to $1.6 million in 2005. Interest income increased from 2004 to 2005 due primarily to higher interest rates.

Provision for income taxes. Provision for income taxes was $1.7 million in 2005. Provision for income taxes from continuing operations was $5.2 million in 2004. Provision for income taxes as a percentage of income before provision for income taxes was 37.0% in 2004 compared to 24.0% in 2005. Provision for income taxes as a percentage of income before provision for income taxes was abnormally low in 2005 due primarily to the completion of a state income tax audit in which the final liability was less than we had previously anticipated and accrued. In addition, we received increased research and development income tax credits as a result of higher research and development spending in 2005 compared to 2004.

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Income from continuing operations. Income from continuing operations was $8.8 million in 2004 and $5.6 million in 2005.

Discontinued Operations. In June 2004, we discontinued the operation of our Xiran Division. No revenues or operating expenses were recorded in the second half of 2004 related to our discontinued Xiran Division. The operating expense figures above do not include operating expenses related to our discontinued Xiran Division during all of 2005 and the first half of 2004.

Comparison of the years ended December 31, 2004 and 2003

Net Revenues. Our revenues increased 30.0% from $211.8 million in 2003 to $275.4 million in 2004. Sales of memory products accounted for 94.3% of our revenues in 2004, compared to 93.3% of our revenues in 2003. The increase in revenues from 2003 to 2004 was due primarily to a 49% increase in our average sales price from $53 in 2003 to $79 in 2004, partially offset by a 13% decrease in units shipped from 4.0 million units in 2003 to 3.5 million units in 2004. The decrease in unit volume resulted from unit volume decreases of 20% for Flash products and 19% for standard memory products, partially offset by a unit volume increase of 51% for IC Tower stacking products and 22% for non-DRAM, non-Flash products such as SRAM, hard drive upgrade kits and connectivity products. The increase in IC Tower stacking units shipped resulted primarily from an increase in sales of IC Tower stacking products to OEM customers in the server and telecom markets. The decrease in Flash product units shipped resulted primarily from Flash supply constraints and negative competitive component pricing issues that we encountered in most of 2004. The increase in our average sales price resulted primarily from a mix shift toward higher average sales price IC Tower stacking products and more stable DRAM component prices in 2004 compared to 2003. The mix of products sold varies from quarter to quarter and may vary in the future, affecting our overall average sales price and gross margin.

Our OEM Division revenues increased 125.5% from $58.4 million in 2003 to $131.7 million in 2004. The increase in OEM Division revenues was due primarily to a 113% increase in average sales price from $67 in 2003 to $143 in 2004, and a 6% increase in OEM Division unit volume. Our OEM Division revenues growth was driven primarily by a significant increase in sales of our higher average selling price IC Tower stacking products. Consumer Division revenues decreased 6.3% from $153.4 million in 2003 to $143.7 million in 2004. The decrease in Consumer Division revenues was due primarily to a 18% decrease in unit volume, partially offset by a 14% increase in average sales price from $49 in 2003 to $56 in 2004. The decrease in unit volume was due primarily to a decrease in the sale of Flash products through the retail channel.

Our combined backlog was $8.1 million as of December 31, 2004, compared to $12.5 million as of December 31, 2003. Our OEM Division backlog was $6.0 million as of December 31, 2004, compared to $7.5 million as of December 31, 2003. Our Consumer Division backlog was $2.1 million as of December 31, 2004, compared to $5.0 million as of December 31, 2003. Since orders constituting our backlog are subject to change due to, among other things, customer cancellations and reschedulings, and our ability to procure necessary components, backlog is not necessarily an indication of future revenues.

Gross Profit. Our gross profit increased 31.5% from $35.9 million in 2003 to $47.2 million in 2004. Gross profit as a percentage of revenues increased nominally from 16.9% in 2003 to 17.1% in 2004. Gross profit as a percentage of revenues for our OEM Division decreased from 22.0% in 2003 to 19.4% in 2004 as a result of a significant shift in product mix toward lower-margin IC Tower stacking products, which also resulted in a 113.4% increase in OEM Division average sales price from 2003 to 2004. Gross profit as a percentage of revenues for our Consumer Division was flat at 15.0% in 2004 and 2003. As a result of our OEM Division selling a larger percentage of higher margin, higher capacity DRAM, Flash memory and IC Tower stacking products, gross profit as a percentage of revenues for our OEM Division is typically higher than our Consumer Division.

Sales and Marketing. Sales and marketing expenses are comprised primarily of personnel costs and travel expenses for our domestic and international sales and marketing employees, commissions paid to internal salespersons and independent manufacturers representatives, shipping costs and marketing programs. Sales and marketing expenses increased from $18.8 million in 2003 to $19.9 million in 2004. Sales and marketing costs increased due primarily to an increase in variable sales and marketing costs that resulted from a larger revenue base. Sales and marketing expenses as a percentage of revenues decreased from 8.9% in 2003 to 7.2% in 2004. Sales and marketing expenses as a percentage of revenues decreased due primarily to leveraging certain fixed sales and marketing costs against a larger revenue base.

General and Administrative. General and administrative expenses are comprised primarily of personnel costs for our executive and administrative employees, professional fees and facilities overhead. General and administrative expenses were $10.1 million in each of 2004 and 2003. General and administrative expenses as a percentage of revenues decreased from 4.8% in 2003 to 3.7% in 2004 due primarily to leveraging certain fixed general and administrative costs against a larger revenue base.

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Research and Development. Research and development expenses are comprised primarily of personnel costs for our engineering and design staff and the cost of prototype supplies. Research and development expenses increased 79.2% from $2.4 million in 2003 to $4.3 million in 2004. Research and development expenses as a percentage of revenues increased from 1.1% in 2003 to 1.5% in 2004. Research and development expenses increased year-over-year from 2003 to 2004 due primarily to our investment in the development of our Flash-based Zeus product line for military applications and our NAS external storage drive product line.

Interest Income. Interest income is comprised primarily of interest income from our cash, cash equivalents and marketable securities. Interest income was $557,000 in 2003 compared to $1.1 million in 2004. Interest income increased from 2003 to 2004 due primarily to a higher average balance of cash, cash equivalents and marketable securities and higher interest rates. The higher average balance of cash, cash equivalents and marketable securities was impacted by the proceeds from our offering of common stock in October 2003.

Provision for income taxes. Provision for income taxes from continuing operations was $1.6 million in 2003 and $5.2 million in 2004. Provision for income taxes as a percentage of income before provision for income taxes was 32.0% in 2003 compared to 37.0% in 2004. The increase in the effective rate in 2004 resulted from the decrease in research and development, state enterprise zone, and manufacturer s investment tax credits available in 2004 compared to 2003.

Income from continuing operations. Income from continuing operations was $3.5 million in 2003 and $8.8 million in 2004.

Discontinued Operations. In June 2004, we discontinued the operation of our Xiran Division. No revenues or operating expenses were recorded in the second half of 2004 related to our discontinued Xiran Division. The operating expense figures above do not include operating expenses related to our discontinued Xiran Division during the first half of 2004 and full year 2003.

Liquidity and Capital Resources

Working Capital, Cash and Marketable Securities

As of December 31, 2005, we had working capital of $114.5 million, including $60.0 million of cash and cash equivalents, compared to working capital of $121.6 million, including $73.3 million of cash and cash equivalents and $10.0 million in marketable securities as of December 31, 2004, and compared to working capital of $114.1 million, including $30.8 million of cash and cash equivalents and $45.6 million in marketable securities as of December 31, 2003. Current assets were 5.1 times current liabilities at the end of 2005, compared to 6.5 times current liabilities at the end of 2004 and 5.5 times current liabilities at the end of 2003.

Cash Provided and Used in Operating Activities in 2005, 2004 and 2003

Net cash used in operating activities was $6.4 million in 2005 resulting primarily from an increase in net inventory of $17.5 million, partially offset by net income of $5.6, an increase in accounts payable of $3.9 and non-cash depreciation of $3.0 million. Net inventory increased due primarily to longer manufacturing cycles for certain products built in Asia in 2005 that were previously built domestically and longer sales cycles for certain customers due to the conversion of inventory arrangements to consignment programs during 2005.

Net cash provided by operating activities was $10.1 million in 2004 resulting primarily from a decrease in net inventory of $6.1 million, net income of $4.7 million, non-cash depreciation and amortization of $3.3 million and loss on disposal of a segment of $3.0 million, partially offset by an increase in net accounts receivable of $4.0 million and a decrease in accounts payable of $3.8 million.

Net cash used in operating activities was $20.0 million in 2003 and resulted primarily from an increase in net accounts receivable of $14.0 million and an increase in net inventory of $12.6 million, partially offset by an increase in accounts payable of $4.0 million and non-cash depreciation and amortization of $3.5 million.

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Cash Provided and Used in Investing Activities in 2005, 2004 and 2003

Net cash provided by investing activities was $3.5 million in 2005 resulting primarily from a $10.0 million decrease in investments in marketable securities, partially offset by purchases of furniture, fixtures and equipment of $5.0 million and an acquisition of a business of $1.6 million.

Net cash provided by investing activities was $34.4 million in 2004 resulting primarily from a decrease in investments in marketable securities of $35.7 million, partially offset by purchases of furniture, fixtures and equipment of $1.5 million.

Net cash used in investing activities of $28.2 million in 2003 resulted primarily from $26.1 million of investments in marketable securities.

Cash Provided and Used Financing Activities in 2005, 2004 and 2003

Although we had no material capital expense commitments as of December 31, 2005, we expect to spend between approximately $2.0 million to $5.0 million during the next 24 months, primarily for manufacturing, testing and engineering equipment.

Net cash used in financing activities was $10.4 million in 2005 resulting primarily from a $11.8 million repurchase of our common stock under our stock buy back plan, partially offset by the issuance of common stock for proceeds of $1.4 million related to our employee stock purchase plan and stock option exercises.

Net cash used in financing activities was $1.9 million in 2004 resulting primarily from a $3.1 million repurchase of our common stock under our stock buy back plan, partially offset by the issuance of common stock for proceeds of $1.2 million related to our employee stock purchase plan and stock option exercises.

Net cash provided by financing activities was $54.5 million in 2003 and was attributable primarily to $53.3 million in proceeds related to the issuance of common stock in our follow-on public offering in the fourth quarter of 2003 and $1.3 million in proceeds related to the issuance of stock related to our employee stock purchase plan and stock option exercises.

In June 2004, our board of directors authorized the purchase of up to $15 million of our outstanding common stock from time to time over the next 18 months. We repurchased 3,045,886 shares of common stock at an average share price of $3.88, including commissions, in 2005, and 841,509 shares of common stock at an average share price of $3.68, including commissions, in 2004. The share repurchase plan expired on December 16, 2005. Repurchased shares were returned to the status of authorized but unissued shares of common stock and may be issued by us in the future.

We believe that our existing assets, cash, cash equivalents and investments on hand, together with cash that we expect to generate from our operations, will be sufficient to meet our capital needs for at least the next twelve months. However, it is possible that we may need or elect to raise additional funds to fund our activities beyond the next year or to consummate acquisitions of other businesses, products or technologies. We could raise such funds by selling more stock to the public or to selected investors, or by borrowing money. In addition, even though we may not need additional funds, we may still elect to sell additional equity securities or obtain credit facilities for other reasons. We cannot assure you that we will be able to obtain additional funds on commercially favorable terms, or at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock.

Although we believe we have sufficient capital to fund our activities for at least the next twelve months, our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will depend on many factors, including:

- our relationships with suppliers and customers;
- the market acceptance of our products;

the levels of promotion and advertising that will be required to launch our new products and achieve and maintain a competitive position in the marketplace;

expansion of our international business, including the opening of offices and facilities in foreign countries;

price discounts on our products to our customers;

our pursuit of strategic transactions, including acquisitions, joint ventures and capital investments;

our business, product, capital expenditure and research and development plans and product and technology roadmaps;

the levels of inventory and accounts receivable that we maintain;

our entrance into new markets;

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capital improvements to new and existing facilities;

technological advances; and

competitors responses to our products.

Contractual Obligations and Off Balance Sheet Arrangements

Set forth in the table below is our estimate of our significant contractual obligations at December 31, 2005. We do not have off-balance sheet financing arrangements as of December 31, 2005.

		Payment due by period			
Contractual Obligation	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Operating Lease Obligations	$ 8,147,000	$ 1,111,000	$ 1,789,000	$ 1,298,000	$ 3,949,000
Non-cancelable capital equipment purchase commitments	$ 431,000	$ 431,000	$	$	$
Non-cancelable inventory purchase commitments	$ 18,027,000	$ 18,027,000	$	$	$
Other non-cancelable purchase commitments	$ 897,000	$ 897,000	$	$	$
Total	$ 27,502,000	$ 20,466,000	$ 1,789,000	$ 1,298,000	$ 3,949,000

Inflation

Inflation was not a material factor in either revenue or operating expenses during the past three years ended December 31, 2005, 2004 and 2003.

New Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS 151, Inventory Costs , which revised ARB 43, relating to inventory costs. This revision is to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). SFAS 151 requires that these items be recognized as a current period charge regardless of whether they meet the criterion specified in ARB 43. In addition, SFAS 151 requires the allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not believe the adoption of SFAS 151 will have a material impact on our consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued SFAS 123(R), Share-Based Payment. This Statement is a revision to SFAS 123, Accounting for Stock-Based Compensation , and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees . SFAS 123(R) requires the measurement of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render service. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) 107 which expresses the views of the SEC regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the SEC s views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB 107 provides guidance related to share-based payment transactions with nonemployees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instrument issues under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation costs related to share-based payment arrangements, the accounting for income tax effects of share-based payments arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of SFAS 123(R), and disclosures in Management s Discussion and Analysis of Financial Condition and Results of Operations subsequent to adoption of SFAS 123(R). We adopted SFAS 123(R) on January 1, 2006, which requires our compensation cost to be recorded as an expense for the portion of outstanding unvested awards, based on the grant-date fair value of those awards calculated using the Black-Scholes option pricing model.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004. The American Jobs Creation Act, or AJCA, introduces a special 9% tax deduction on qualified production activities. FAS 109-1 clarifies that this tax deduction

should be accounted for as a special tax deduction in accordance with Statement 109. The adoption of this new tax provision has not had a material impact on our consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004. The AJCA introduces a limited time 85% dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FAS 109-2 provides accounting and disclosure guidance for the repatriation provision. To achieve the deduction, the repatriation must occur by the end of 2005. The adoption of this new tax provision has not had a material impact on our consolidated financial position, results of operations or cash flows.

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In December 2004, the FASB issued SFAS 153, Exchanges of Nonmonetary Assets, which changes the guidance in APB Opinion 29, Accounting for Nonmonetary Transactions . This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective during fiscal years beginning after June 15, 2005. We do not believe the adoption of SFAS 153 will have a material impact on our consolidated financial position, results of operations or cash flows.

In June 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections a replacement of APB No. 20 and FAS No. 3 . SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. SFAS 154 also provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The correction of an error in previously issued financial statements is not an accounting change. However, the reporting of an error correction involves adjustments to previously issued financial statements similar to those generally applicable to reporting an accounting change retrospectively. Therefore, the reporting of a correction of an error by restating previously issued financial statements is also addressed by SFAS 154. SFAS 154 is required to be adopted in fiscal years beginning after December 15, 2005. We do not believe the adoption of SFAS 154 will have a material impact on our consolidated financial position, results of operations or cash flows.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses for each period. The following represents a summary of our critical accounting policies, defined as those policies that we believe are: (a) the most important to the portrayal of our financial condition and results of operations, and (b) that require management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

Reserves for inventory excess, obsolescence and lower of market values over costs. We purchase raw materials in quantities that we anticipate will be fully used in the near term. Changes in operating strategy, customer demand and unpredictable fluctuations in market values of raw materials can limit our ability to effectively utilize all of the raw materials purchased and result in finished goods with above market carrying costs which may cause losses on sales to customers. We regularly monitor potential excess, or obsolete, inventory by analyzing the length of time in stock and compare market values to cost. When necessary, we reduce the carrying amount of our inventory to its market value.

Allowances for doubtful accounts and price protection. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We review our allowance for doubtful accounts quarterly and all past due balances over 90 days are reviewed for collectibility. Additionally, we maintain allowances for limited price protection rights for inventories of our products held by our customers as a result of recent sales transactions to them. If we reduce the list price of our products, these customers may receive a credit from us. By monitoring our inventory levels with our customers, we estimate the impact of such pricing changes on a regular basis and adjust our allowances accordingly.

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Product returns. We offer a majority of our customers that purchase products through our consumer channels limited rights to return unsold inventory. In addition, while we may not be contractually obligated to accept returned products, we may determine that it is in our best interest to accept returns in order to maintain good relationships with our customers. We provide for estimated future returns of inventory at the time of sale based on historical experience, and actual results have been within our expectations.

Sales and marketing incentives. Sales and marketing incentives are offset against revenues or charged to operations in accordance with Emerging Issues Task Force Issue No. 01-09 (EITF 01-09), *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)* . Sales and marketing incentives amounted to $9.1 million for 2005, $7.4 million for 2004 and $8.4 million for 2003, of which $8.6 million, $5.2 million and $4.9 million, respectively, were offset against revenues, and $486,000, $2.2 million and $3.5 million, respectively, were charged as an operating expense.

Consideration generally given by us to a customer is presumed to be a reduction of selling price, and therefore, a reduction of revenue. However, if we receive an identifiable benefit in return for the consideration given to our customer that is sufficiently separable from our sales to that customer, such that we could have paid an independent company to receive that benefit; and we can reasonably estimate the fair value of that benefit, then the consideration is characterized as an expense. We estimate the fair value of the benefits we receive by tracking the advertising done by our customers on our behalf and calculating the value of that advertising using a comparable rate for similar publications.

Income taxes. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. The process incorporates an assessment of the current tax exposure together with temporary differences resulting from different treatment of transactions for tax and financial statement purposes. Such differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. The recovery of deferred tax assets from future taxable income must be assessed and, to the extent that recovery is not likely, we establish a valuation allowance. Increases in valuation allowances result in the recording of additional tax expense. Further, if our ultimate tax liability differs from the periodic tax provision reflected in the consolidated statements of operations, additional tax expense may be recorded.

Litigation and other contingencies. Management regularly evaluates our exposure to threatened or pending litigation and other business contingencies. Because of the uncertainties related to the amount of loss from litigation and other business contingencies, the recording of losses relating to such exposures requires significant judgment about the potential range of outcomes. As additional information about current or future litigation or other contingencies becomes available, our management will assess whether such information warrants the recording of additional expense relating to our contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Valuation of long-lived assets. We assess the potential impairment of long-lived tangible and intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Changes in our operating strategy can significantly reduce the estimated useful life of such assets.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

At any time, fluctuations in interest rates could affect interest earnings on our cash and cash equivalents. We believe that the effect, if any, of reasonably possible near term changes in interest rates on our financial position, results of operations, and cash flows would not be material. Currently, we do not hedge these interest rate exposures. The primary objective of our investment activities is to preserve capital. We have not used derivative financial instruments in our investment portfolio.

At December 31, 2005, our cash and cash equivalents were $60.0 million invested in money market and other interest bearing accounts. At December 31, 2005, we had no investments in marketable securities.

If interest rates were to decrease 1%, the result would be an annual decrease in our interest income related to our cash and cash equivalents of approximately $600,000. However, due to the uncertainty of the actions that would be taken and their possible effects, this analysis assumes no such action. Further, this analysis does not consider the effect of the change in the level of overall economic activity that could exist in such an environment.

The carrying amount, principal maturity and estimated fair value of our cash and cash equivalents as of December 31, 2005 were as follows:

	Expected Maturity Date			
	2005	Thereafter	Total	Fair Value 12/31/2005
Investments				
Cash and cash equivalents:				
Money Market Funds	$ 60,006,000	$ 0	$ 60,006,000	$ 60,006,000
Weighted average interest rate	3.37%		3.37%	3.37%

Foreign Currency Exchange Rate Risk

More than 95.0% of our international sales are denominated in U.S. dollars. Consequently, if the value of the U.S. dollar increases relative to a particular foreign currency, our products could become relatively more expensive. In addition, we purchase substantially all of our IC components from local distributors of Japanese, Korean and Taiwanese suppliers. Fluctuations in the currencies of Japan, Korea or Taiwan could have an adverse impact on the cost of our raw materials. To date, we have not entered any derivative instruments to manage risks related to interest rate or foreign currency exchange rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SimpleTech, Inc. s consolidated financial statements and schedule required by this item are included in Part IV, Item 15 of this Report.

The supplementary data required by this item is included in Note 14 to SimpleTech, Inc. s consolidated financial statements.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. An evaluation as of the end of the period covered by this report was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and Rule 15d 15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective to ensure that we record, process, summarize, and report information required to be disclosed by us in our reports filed under the Securities Exchange Act within the time periods specified by the

Securities and Exchange Commission s rules and forms.

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(b) Changes in Internal Control Over Financial Reporting. During the fourth quarter of 2005, there have not been any changes in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item is included in Proposal No. 1: Elections of Directors Management , and Section 16(a) Beneficial Ownership Reporting Compliance sections of our Proxy Statement to be filed in connection with our 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is included in the Executive Compensation and Related Information section of our Proxy Statement to be filed in connection with our 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

Equity Compensation Plan Information

The following table provides information as of December 31, 2005 with respect to the shares of our common stock that may be issued under our existing equity compensation plans.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a) (c)
Equity Compensation Plans Approved by Shareholders (1)	10,452,888	$ 4.25	1,495,941(2)
Equity Compensation Plans Not Approved by Shareholders			
Total	10,452,888		1,495,941

(1) Consists of the 2000 Stock Incentive Plan. Does not include information concerning our Employee Stock Purchase Plan, which was terminated by our board of directors on December 19, 2005.

(2) Consists of shares available for future issuance under the 2000 Stock Incentive Plan. The number of shares of common stock available for issuance under the 2000 Stock Incentive Plan automatically increases on the first trading day of January each calendar year by an amount equal to 4% of the total number of shares of common stock outstanding on the last trading day in December of the prior calendar year, but in no event will any such annual increase exceed 2,500,000 shares of common stock.

The other information required by this Item is included in the Security Ownership of Certain Beneficial Owners and Management sections of our Proxy Statement to be filed in connection with our 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item is included in the Compensation Committee Interlocks and Insider Participation and Certain Transactions sections of our Proxy Statement to be filed in connection with our 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

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ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is included in Proposal No. 3: Ratification of Independent Registered Public Accounting Firm section of our Proxy Statement to be filed in connection with our 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

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PART IV.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this Report:

1. Financial Statements. The following financial statements of SimpleTech, Inc. are included in a separate section of this Annual Report on Form 10-K commencing on the pages referenced below:

	Page
SimpleTech, Inc. Consolidated Financial Statements	
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets at December 31, 2005 and 2004	F-3
Consolidated Statements of Operations for each of the three years in the period ended December 31, 2005	F-4
Consolidated Statements of Shareholders Equity for each of the three years in the period ended December 31, 2005	F-5
Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2005	F-6
Notes to Consolidated Financial Statements	F-7

2. **Financial Statement Schedule.** The following financial statement schedule is included in a separate section of this Annual Report on Form 10-K commencing on the pages referenced below. All other schedules have been omitted because they are not applicable, not required, or the information is included in the consolidated financial statements or notes thereto.

	Page
Report of Independent Registered Public Accounting Firm on Financial Statement Schedule	F-23
Schedule II Valuation and Qualifying Accounts and Reserves	S-1

3. **Exhibits.** The exhibits listed on the accompanying index to exhibits in Item 15(b) below are filed as part of, or hereby incorporated by reference into, this Annual Report on Form 10-K.

(b) Exhibits

The following exhibits are filed (or furnished) herewith or incorporated herein by reference to the location indicated.

Number	Description	Location
3.1	Amended and Restated Articles of Incorporation	Exhibit 3.1 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 3, 2000.
3.1.1	Certificate of Amendment to the Amended and Restated Articles of Incorporation, dated August 31, 2000	Exhibit 3.3 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed September 27, 2000.
3.1.2	Certificate of Amendment to the Amended and Restated Articles of Incorporation, dated May 1, 2001.	Exhibit 3.1 to the Quarterly Report on Form 10-Q of the registrant for the quarter ended March 31, 2001, filed May 14, 2001.
3.2	Amended and Restated Bylaws	Exhibit 3.2 to the Registration Statement on Form S-1 (File No. 333-32478) of the registrant, filed March 15, 2000.
4.1	See Exhibits 3.1 and 3.2 for provisions of the Articles of Incorporation and Bylaws for SimpleTech, Inc. defining the rights of holders of common stock of SimpleTech, Inc.	

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4.2	Specimen Stock Certificate	Exhibit 4.2 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 28, 2000.
10.1	Amended and Restated Real Estate Lease, dated April 1, 2000, by and between MDC Land LLC and SimpleTech, Inc.	Exhibit 10.1 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 3, 2000.
10.2	Amended and Restated Real Estate Lease, dated June 1, 2000, by and between MDC Land LLC and SimpleTech, Inc.	Exhibit 10.2 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 3, 2000.
10.3	2000 Stock Incentive Plan (as amended and restated)	Exhibit 99.1 to the Registration Statement on Form S-8 (File No. 333-124387) of the registrant, filed April 28, 2005.
10.4	Form of Indemnification Agreement between SimpleTech, Inc. and each of its directors and officers	Exhibit 10.7 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 3, 2000.
10.5	Form of Employment Agreement for Executive Officers of SimpleTech, Inc. (including a schedule of substantially identical agreements)	Exhibit 10.8 to the Registration Statement on Form S-1 (File No. 333-32478) of the registrant, filed March 15, 2000.
10.6	Distribution and Tax Indemnity Agreement, dated September 26, 2000, by and between SimpleTech, Inc. and each of the shareholders of SimpleTech, Inc.	Exhibit 10.9 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 28, 2000.
10.7	License Agreement, dated August 22, 2000, by and between Micron Electronics and SimpleTech, Inc.	Exhibit 10.25 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed September 6, 2000.
10.8	Amendment No. 1 to Amended and Restated Real Estate Lease, dated April 29, 2002, by and between MDC Land, LLC and SimpleTech, Inc. (24,500 sq. ft. facility)	Exhibit 10.10 to the Registration Statement on Form S-1/A (File No. 333-109372) of the registrant, filed October 15, 2003.
10.9	Amendment No. 1 to Amended and Restated Real Estate Lease, dated April 29, 2002, by and between MDC Land, LLC and SimpleTech, Inc. (48,600 sq. ft. facility)	Exhibit 10.11 to the Registration Statement on Form S-1/A (File No. 333-109372) of the registrant, filed October 15, 2003.
10.10	Description of Compensatory Arrangements for 2005 Applicable to Named Executive Officers	Exhibit 10.12 to the Annual Report on Form 10-K of the registrant for the year ended December 31, 2004, filed March 16, 2005.
10.11	Summary of Non-Employee Director Compensation Arrangements	Exhibit 99.1 to the Current Report on Form 8-K filed October 20, 2005.
21.1	List of Subsidiaries of SimpleTech, Inc.	Filed herewith.
23.1	Consent of PricewaterhouseCoopers LLP	Filed herewith.
31.1	Section 302 Certification of Chief Executive Officer	Filed herewith.
31.2	Section 302 Certification of Chief Financial Officer	Filed herewith.
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Furnished herewith pursuant to SEC Release No. 33-8238.
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Furnished herewith pursuant to SEC Release No. 33-8238.

Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(c) of Form 10-K.

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* The information in Exhibits 32.1 and 32.2 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or otherwise subject to the liabilities of that section, nor shall they be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act (including this Report), unless SimpleTech, Inc. specifically incorporates the foregoing information into those documents by reference.

(c) Financial Statement Schedule:

The financial statement schedule for SimpleTech, Inc. is set forth in (a)(2) of Item 15 above.

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SIMPLETECH, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Directors of

SimpleTech, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, shareholders equity and cash flows present fairly, in all material respects, the financial position of SimpleTech, Inc. and its subsidiaries (the Company) at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Orange County, California
March 29, 2006

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SIMPLETECH, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

	December 31, 2005	December 31, 2004
ASSETS:		
Current Assets:		
Cash and cash equivalents	$ 60,006	$ 73,346
Marketable securities, held to maturity		9,972
Accounts receivable, net of allowances of $878 at December 31, 2005 and $993 at December 31, 2004	38,630	37,047
Inventory, net	37,108	19,002
Deferred income taxes	1,410	1,515
Other current assets	5,139	2,663
Total current assets	142,293	143,545
Furniture, fixtures and equipment, net	8,231	6,146
Intangible assets	1,036	373
Goodwill	733	
Other long-term assets	333	
Deferred income taxes	2,515	3,345
Total assets	$ 155,141	$ 153,409
LIABILITIES AND SHAREHOLDERS EQUITY:		
Current Liabilities:		
Accounts payable	$ 20,564	$ 16,553
Accrued and other liabilities (Note 5)	7,195	5,428
Total liabilities	27,759	21,981
Commitments and contingencies (Note 9)		
Shareholders Equity:		
Preferred stock, $0.001 par value, 20,000,000 shares authorized, no shares outstanding		
Common stock, $0.001 par value, 100,000,000 shares authorized, 45,043,568 shares issued and outstanding as of December 31, 2005 and 47,450,722 shares issued and outstanding as of December 31, 2004	45	47
Additional paid-in capital	111,576	121,193
Retained earnings	15,761	10,188
Total shareholders equity	127,382	131,428
Total liabilities and shareholders equity	$ 155,141	$ 153,409

The accompanying notes are an integral part of these consolidated financial statements

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SIMPLETECH, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share amounts)

	Year Ended December 31,		
	2005	2004	2003
Net revenues	$ 261,988	$ 275,432	$ 211,806
Cost of revenues	212,887	228,269	175,927
Gross profit	49,101	47,163	35,879
Sales and marketing	24,179	19,875	18,787
General and administrative	12,705	10,106	10,077
Research and development	6,560	4,295	2,445
Total operating expenses	43,444	34,276	31,309
Operating income	5,657	12,887	4,570
Interest income	1,629	1,052	557
Income from continuing operations before provision for income taxes	7,286	13,939	5,127
Provision for income taxes	1,713	5,158	1,645
Income from continuing operations	5,573	8,781	3,482
Loss from discontinued operations before benefit for income taxes		(7,115)	(8,728)
Benefit for income taxes		(3,023)	(3,598)
Loss from discontinued operations		(4,092)	(5,130)
Net income (loss)	$ 5,573	$ 4,689	($ 1,648)
Net income (loss) per share:			
Basic:			
Continuing operations	$ 0.12	$ 0.18	$ 0.09
Discontinued operations		0.08	(0.13)
Total	$ 0.12	$ 0.10	($ 0.04)
Diluted:			
Continuing operations	$ 0.12	$ 0.17	$ 0.08
Discontinued operations		(0.08)	(0.12)
Total	$ 0.12	$ 0.09	($ 0.04)
Shares used in per share computation:			
Basic	45,243,141	47,707,365	40,408,610
Diluted	46,624,517	49,563,208	42,559,586

The accompanying notes are an integral part of these consolidated financial statements.

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SIMPLETECH, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(in thousands, except share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid In Capital	Retained Earnings	Total Shareholders Equity
Balances, December 31, 2002	38,725,800	$ 39	$ 66,716	$ 7,147	$ 73,902
Net loss				(1,648)	(1,648)
Issuance of common shares under stock offering	8,100,000	8	53,122		53,130
Exercise of stock options	854,792	1	1,303		1,304
Issuance of common shares under employee stock purchase plan	95,665		203		203
Tax benefits from exercise of stock options			1,433		1,433
Balances, December 31, 2003	47,776,257	48	122,777	5,499	128,324
Net income				4,689	4,689
Repurchase of common shares	(841,509)	(1)	(3,098)		(3,099)
Exercise of stock options	419,964		963		963
Issuance of common shares under employee stock purchase plan	96,010		218		218
Tax benefits from exercise of stock options			333		333
Balances, December 31, 2004	47,450,722	47	121,193	10,188	131,428
Net income				5,573	5,573
Repurchase of common shares	(3,045,886)	(3)	(11,824)		(11,827)
Exercise of stock options	551,956	1	1,178		1,179
Issuance of common shares under employee stock purchase plan	86,776		238		238
Acceleration of stock option vesting			374		374
Tax benefits from exercise of stock options			417		417
Balances, December 31, 2005	45,043,568	$ 45	$ 111,576	$ 15,761	$ 127,382

The accompanying notes are an integral part of these consolidated financial statements.

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SIMPLETECH, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2005	**2004**	**2003**
Cash flows from operating activities:			
Net income (loss)	$ 5,573	$ 4,689	($ 1,648)
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Depreciation and amortization	3,022	3,250	3,542
(Gain) loss on sale of furniture, fixtures and equipment	75	(27)	(50)
Restructuring and impairment charges		50	(141)
Loss on disposal of segment		2,979	
Accounts receivable provisions	998	1,156	2,164
Inventory excess and obsolescence expense	1,361	1,142	367
Deferred income taxes	593	804	(3,258)
Compensation related to stock options vesting	374		
Tax benefit from exercise of stock options	417	333	1,433
Change in operating assets and liabilities:			
Accounts receivable	(2,098)	(5,177)	(16,181)
Inventory	(18,851)	4,961	(12,930)
Other assets	(2,791)	(490)	1,623
Accounts payable	3,876	(3,776)	4,007
Accrued and other liabilities	1,055	218	1,113
Net cash provided (used in) by operating activities	(6,396)	10,112	(19,959)
Cash flows from investing activities:			
Marketable securities	9,972	35,653	(26,095)
Purchase of intangible assets		(400)	
Purchase of furniture, fixtures and equipment	(4,989)	(1,465)	(2,329)
Proceeds from sale of furniture, fixtures and equipment	43	595	186
Acquisition of business	(1,561)		
Net cash provided by (used in) investing activities	3,465	34,383	(28,238)
Cash flows from financing activities:			
Payments on capital lease obligations			(113)
Proceeds from exercise of stock options	1,178	1,215	1,304
Stock buyback	(11,827)	(3,099)	
Proceeds from issuance of common stock	238	(34)	53,333
Net cash (used in) provided by financing activities	(10,411)	(1,918)	54,524
Net increase (decrease) in cash	(13,342)	42,577	6,327
Cash and cash equivalents at beginning of period	73,346	30,769	24,442
Cash and cash equivalents at end of period	$ 60,004	$ 73,346	$ 30,769
Supplemental disclosure of cash flow information:			
Cash paid during the year:			

Income taxes	$ 1,214	$ 890	$ 6

The accompanying notes are an integral part of these consolidated financial statements.

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SIMPLETECH, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Company Organization:

SimpleTech, Inc. (the Company) was originally incorporated in California in March 1990 as Simple Technology, Inc. and renamed SimpleTech, Inc. in May 2001. SimpleTech designs, develops, manufactures and markets custom and open-standard memory solutions based on Flash memory and dynamic random access memory, or DRAM, technologies an external storage solutions. Headquartered in Santa Ana, California, the Company specializes in developing high-density DRAM memory modules and high-speed, high-capacity solid-state Flash drives and memory cards used in sensitive and highly-volatile environments. These products are used in consumer electronics, high-performance computing, defense and aerospace, networking and communications and Original Equipment Manufacturer, or OEM, applications. The Company offers its products through its OEM Division and Consumer Division.

2. Summary of Significant Accounting Policies:

Basis of Presentation:

The accompanying consolidated financial statements include the accounts of SimpleTech, Inc. and its subsidiaries in California, the Cayman Islands, Hong Kong, the Netherlands, and Scotland (collectively, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation. As disclosed in Note 6, we have presented the Xiran division as a discontinued operation.

Cash and Cash Equivalents:

Cash and cash equivalents consist primarily of cash in banks and money market funds. All highly liquid investments with an original maturity date of three months or less when acquired are considered to be cash equivalents. Cash and cash equivalents are carried at cost, which approximates market value.

Marketable Securities:

Marketable securities consist primarily of certificates of deposit with an original maturity of one year at several different financial institutions and auction rate securities. The certificates of deposit are classified as held-to-maturity because the Company has the intent and ability to hold the securities to maturity. The auction rate securities are available for sale. These securities are stated at cost, which approximates fair market value, and the gross unrealized gains and losses on these securities have historically not been material.

Accounts Receivable:

Accounts receivable consist of trade receivables recorded upon recognition of revenue for product sales, reduced by reserves for the estimated amount deemed uncollectible due to bad debt, price protection and sales returns. The allowance for doubtful accounts is the Company s best estimate of the amount of probable credit losses in its existing accounts receivable. The Company reviews its allowance for doubtful accounts quarterly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by type of receivable. Account balances are charged off against the allowance when the Company believes it is probable the receivable will not be recovered. The Company does not have any off-balance-sheet credit exposure related to its customers. If the Company reduces the list price of its products, certain customers may receive a credit from the Company. The Company estimates the impact of such pricing changes on a regular basis and adjusts its allowances accordingly. Amounts charged to operations for price protection are calculated based on actual price changes on individual products multiplied by customer inventory levels. The reserve is then reduced by actual credits given to these customers at the time the credits are issued. The sales returns reserve is based on historical relationship to revenues and current contract sales terms.

Following are the changes in the account receivable allowance for doubtful accounts, sales returns, price protection and other deductions, during the years ended December 31, 2005, 2004 and 2003 (amounts in thousands):

Additions

	Balance at Beginning of year		Write-offs net of recoveries	Balance at end of year
December 31, 2005	$ 993	$ 998	($ 1,113)	$ 878
December 31, 2004	$ 1,129	$ 1,155	($ 1,291)	$ 993
December 31, 2003	$ 782	$ 2,164	($ 1,817)	$ 1,129

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Inventory:

Inventory is stated at the lower of cost or market, with cost being determined on the first-in, first-out (FIFO) method of accounting. The Company purchases raw materials in quantities that it anticipates will be fully used in the near term. Changes in operating strategy, customer demand and unpredictable fluctuations in market values of raw materials can limit the Company s ability to effectively utilize all of the raw materials purchased and result in finished goods with above market carrying costs which may cause losses on sales to customers. The Company regularly monitors potential inventory excess, obsolescence and lower market values compared to costs and, when necessary, reduces the carrying amount of its inventory to its market value.

Furniture, Fixtures and Equipment:

Furniture, fixtures and equipment are stated at cost and depreciated using the straight-line method. The Company s estimated useful lives of the assets, other than leasehold improvements, range from four to five years for equipment and seven years for furniture and fixtures. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the assets.

Expenditures for major renewals and betterments are capitalized, while minor replacements, maintenance and repairs, which do not extend the asset lives, are charged to operations as incurred. Upon sale or disposition, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations.

The Company continually monitors events and changes in circumstances that could indicate that the carrying balances of its furniture, fixtures and equipment may not be recoverable in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, Disposal of Long-Lived Assets. When such events or changes in circumstances are present, the Company assesses the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future cash flows is less than the carrying amount of those assets, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of the assets.

Revenue Recognition:

Revenue is recognized in accordance with the guidelines in Staff Accounting Bulletin No. 104, *Revenue Recognition.* Revenue is realized or realizable and earned when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) the sales price is fixed or determinable, (3) collectibility is reasonably assured and (4) products have been shipped and the customer has taken ownership and assumed risk of loss. For customers with unlimited rights of return, revenue is recognized when units are sold through. A substantial portion of the Company s product sales are on FOB shipping point terms where product title passes to our customer at the time it is shipped from the Company s warehouse. Products sales on FOB destination terms are not recognized until delivered to the customer. A substantial portion of the Company s sales through its Consumer Division includes limited rights to return unsold inventory. In addition, some customers have limited price protection rights for inventories of the Company s products held by them. If the Company reduces the list price of their products, these customers may be entitled to receive credits from the Company. The Company provides for estimated future returns, limited price protection arrangements and the estimated costs of warranty at the time of sale based on historical experience. If the historical data and inventory estimates used to calculate these provisions do not properly reflect future activity, the Company s financial position, results of operations and cash flows could be impacted.

Shipping and Handling Costs:

Shipping and handling costs incurred in a sales transaction to ship products to a customer are included in sales and marketing. For the years ended December 31, 2005, 2004 and 2003, shipping and handling costs were approximately $2,400,000, $2,171,000 and $2,300,000, respectively. Amounts billed to customers for shipping and handling are included in revenues. For the years ended December 31, 2005, 2004 and 2003, shipping and handling costs billed to customers were $313,000, $317,000 and $408,000, respectively.

Sales and marketing incentives:

Sales and marketing incentives are offset against revenues or charged to operations in accordance with Emerging Issues Task Force Issue No. 01-09 (EITF 01-09), *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products).* For the years ended December 31, 2005, 2004 and 2003, sales and marketing incentives amounted to $9,115,000, $7,438,000 and $8,427,000, of which $8,629,000, $5,256,000 and $4,932,000, respectively, were offset against revenues, and $486,000, $2,182,000 and $3,495,000, respectively, were charged as an operating expense.

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Consideration generally given by the Company to a customer is presumed to be a reduction of selling price, and therefore, a reduction of revenue. However, if the Company receives an identifiable benefit in return for the consideration given to its customer that is sufficiently separable from the Company s sales to that customer, such that the Company could have paid an independent company to receive that benefit; and the Company can reasonably estimate the fair value of that benefit, then the consideration is characterized as an expense. The Company estimates the fair value of the benefits it receives by tracking the advertising done by its customers on the Company s behalf and calculating the value of that advertising using a comparable rate for similar publications.

Advertising Costs:

Advertising costs, which relate primarily to various print media expenditures, are expensed as incurred. For the years ended December 31, 2005, 2004, and 2003, advertising costs were approximately $222,000, $1,600,000 and $2,114,000, respectively.

Research and Development:

Research and development costs, which primarily relate to payroll-related costs, product design consulting fees and rent expense for office space, are expensed as incurred.

Income Taxes:

Deferred income taxes are recognized for the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amount expected to be realized. The provision for income taxes represents the tax payable for the year and the change during the year in deferred income tax assets and liabilities.

Stock-Based Compensation:

In October 1995, the Financial Accounting Standards Board (FASB) issued SFAS 123, Accounting for Stock-Based Compensation. SFAS 123 encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. During the fiscal years ended December 31, 2005, 2004 and 2003, the Company elected to continue to follow Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , and related interpretations in accounting for its employee stock options. Under the provisions of APB No. 25, the Company recognizes compensation expense only to the extent that the exercise price of the Company s employee stock options is less than the market price of the underlying stock on the date of grant. Pro forma information regarding net loss and loss per share is required by SFAS 123, which also requires that the information be determined as if the Company has accounted for its employee stock options granted under the fair value method. The fair value method for these options was estimated at the date of grant using the Black-Scholes option-pricing model. The Black-Scholes model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility.

In December 2004, the FASB issued SFAS 123(R), Share-Based Payment, which is a revision of SFAS 123 and supersedes APB No. 25. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosure of the income statement effects of share-based payments is no longer an alternative. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of the effective date. Compensation expense for the unvested awards will be measured based on the fair value. On April 14, 2005, the U.S. Securities and Exchange Commission (SEC) adopted a new rule amending the compliance dates for SFAS 123(R). In accordance with the new rule, the accounting provisions of SFAS 123(R) became effective for the Company on January 1, 2006.

On December 19, 2005, the Company s board of directors approved the termination of its Employee Stock Purchase Plan (ESPP) and the acceleration of the vesting of all then current unvested stock options awarded under its 2000 Stock Incentive Plan, including stock options held by its employees, officers, directors and consultants. As a result of this action, stock options to purchase approximately 5.6 million shares of common stock became exercisable effective December 19, 2005, representing approximately 56% of the Company s total current outstanding stock options as of such date. All other terms and conditions applicable to such stock options, including the exercise prices, remain unchanged. The decision to terminate the ESPP and accelerate vesting of the stock options was made primarily to avoid recognizing the related

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compensation expense in the Company s future consolidated financial statements with respect to the shares issued under the ESPP and the unvested stock options upon the Company s adoption of SFAS 123(R). The Company had no unvested stock options at December 31, 2005.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options vesting period. The table below sets forth the Company s pro forma information for the years ended December 31, 2005, 2004 and 2003, assuming the Company had determined compensation cost for awards under stock option plans and the ESPP based on the fair value at the grant date. This calculation is consistent with the provisions of SFAS 123, as amended by SFAS 148. The pro forma information in the table below also reflects for the year ended December 31, 2005 approximately $374,000 of compensation expense, the effect of the Company s acceleration of all unvested stock options in December 2005:

	Year Ended December 31,		
	2005	2004	2003
Net Income, as reported	$ 5,573,000	$ 4,689,000	$ (1,648,000)
Add: Stock-based employee compensation expense, net of related tax effects	286,000		
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(14,169,000)	(4,302,000)	(3,444,000)
Pro forma net income (loss)	$ (8,310,000)	$ 387,000	$ (5,092,000)
Net income per share:			
Basic as reported	$ 0.12	$ 0.10	$ (0.04)
Basic pro forma	$ (0.18)	$ 0.01	$ (0.13)
Diluted as reported	$ 0.12	$ 0.10	$ (0.04)
Diluted pro forma	$ (0.18)	$ 0.01	$ (0.13)
Weighted average shares outstanding:			
Basic	45,243,141	47,707,365	40,408,610
Diluted	45,243,141	48,366,698	40,408,610

For purposes of computing the pro forma amounts, the fair value of stock-based compensation was estimated using the Black Scholes option-pricing model with the following assumptions:

	2005	2004	2003
Weighted-average expected life (years)	5.8	5.0	5.0
Annual dividend per share	none	none	none
Risk-free interest rate	3.63% to 4.45%	2.86% to 3.96%	2.14% to 3.50%
Expected volatility	85%	63%	63%

The Company accounts for non-employee stock-based awards, in which goods or services are the consideration received for the stock options issued, in accordance with the provisions of SFAS 123 and related interpretations. Compensation expense for non-employee stock-based awards is recognized in accordance with FASB Interpretation 28, Accounting for Stock Appreciation Rights and Other Variable Stock Options or Award Plans, an Interpretation of APB Opinions No. 15, and 25 (FIN 28). Under SFAS 123 and FIN 28, the Company records compensation expense based on the then-current fair values of the stock options at each financial date. Compensation recorded during the service period is adjusted in subsequent periods for changes in the stock options fair value.

Per Share Information:

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding. In computing diluted earnings per share, the weighted average number of shares outstanding is adjusted to additionally reflect the effect of potentially dilutive securities.

For the year ended December 31, 2005, 2004 and 2003, potentially dilutive securities consisted solely of options and resulted in potential common shares of 1,381,376, 1,855,843 and 2,150,976, respectively.

The Company repurchased 3,045,886 shares of common stock at an average share price of $3.88, including commissions, in 2005, and 841,509 shares of common stock at an average share price of $3.68, including commissions, in 2004. The

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repurchase plan approved by the Company s board of directors in June 2004 expired on December 16, 2005. Repurchased shares were returned to the status of authorized but unissued shares of common stock and may be issued by the Company in the future.

Risks and Uncertainties:

Financial instruments, which potentially subject the Company to a concentration of credit risk, principally consist of cash and cash equivalents and accounts receivable.

As shown in the table below, customer concentrations of accounts receivable and revenues of greater than 10% were as follows:

	Twelve months ended December 31,			
	2005		2004	
	Accounts Receivable	Revenues	Accounts Receivable	Revenues
Customer A	11%	18%	15%	14%
Customer B	11%	15%	13%	21%
Customer C	*	15%	11%	18%
Customer D	11%	*	*	*
Customer E	10%	*	*	*
Total	43%	48%	39%	53%

* Less than 10%

No other single customer accounted for more than 10% of accounts receivable or revenues at December 31, 2005 and 2004, or for each of the three years in the period ended December 31, 2005. The Company generally does not require collateral on accounts receivable as the majority of the Company s customers are large, well-established companies. Historically, bad debt provisions have been consistent with management s expectations.

At December 31, 2005 and 2004, the Company had amounts on deposit with financial institutions that were in excess of the federally insured limit of $100,000.

The manufacturing operations of the Company are concentrated in facilities located in Santa Ana, California. As a result of this geographic concentration, a disruption in the manufacturing process resulting from a natural disaster or other unforeseen event could have a material adverse effect on the Company s financial position and results of operations.

Certain of the Company s products utilize components that are purchased from a small number of sources with whom the Company has no long-term contracts. An inability to obtain such components in the amounts needed on a timely basis or at commercially reasonable prices could result in delays in product introductions, interruptions in product shipments or increases in product costs, which could have a material adverse effect on the Company s financial position and results of operations.

Warranties:

The Company s memory products are generally sold under various limited warranty arrangements ranging from one year to lifetime. The historical and estimated future costs of repair or replacement are immaterial.

Management Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent 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.

Comprehensive Income:

SFAS 130, Reporting Comprehensive Income establishes requirements for reporting and disclosure of comprehensive income (loss) and its components. Comprehensive income (loss) includes unrealized holding gains and losses and other items that have previously been excluded from net income and reflected instead in shareholders equity. The Company did not have any material items of other comprehensive income or loss other than net income (loss) in the years ended December 31, 2005, 2004 and 2003.

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New Accounting Pronouncements:

In November 2004, the FASB issued SFAS 151, Inventory Costs , which revised ARB 43, relating to inventory costs. This revision is to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). SFAS 151 requires that these items be recognized as a current period charge regardless of whether they meet the criterion specified in ARB 43. In addition, SFAS 151 requires the allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not believe the adoption of SFAS 151 will have a material impact on its consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued SFAS 123(R), Share-Based Payment. This Statement is a revision to SFAS 123, Accounting for Stock-Based Compensation , and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees . SFAS 123(R) requires the measurement of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render service. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) 107 which expresses the views of the SEC regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the SEC s views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB 107 provides guidance related to share-based payment transactions with nonemployees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instrument issues under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation costs related to share-based payment arrangements, the accounting for income tax effects of share-based payments arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of SFAS 123(R), and disclosures in Management s Discussion and Analysis of Financial Condition and Results of Operations subsequent to adoption of SFAS 123(R). The Company adopted SFAS 123(R) on January 1, 2006, which requires its compensation cost to be recorded as an expense for the portion of outstanding unvested awards, based on the grant-date fair value of those awards calculated using the Black-Scholes option pricing model.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004. The American Jobs Creation Act, or AJCA, introduces a special 9% tax deduction on qualified production activities. FAS 109-1 clarifies that this tax deduction should be accounted for as a special tax deduction in accordance with Statement 109. The adoption of this new tax provision has not had a material impact on the Company s consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004. The AJCA introduces a limited time 85% dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FAS No. 109-2 provides accounting and disclosure guidance for the repatriation provision. To achieve the deduction, the repatriation must occur by the end of 2005. The adoption of this new tax provision has not had a material impact on the Company s consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued SFAS 153, Exchanges of Nonmonetary Assets, which changes the guidance in APB Opinion 29, Accounting for Nonmonetary Transactions . This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective during fiscal years beginning after June 15, 2005. The Company does not believe the adoption of SFAS 153 will have a material impact on its consolidated financial position, results of operations or cash flows.

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In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB No. 20 and FAS No. 3 . SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. SFAS 154 also provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The correction of an error in previously issued financial statements is not an accounting change. However, the reporting of an error correction involves adjustments to previously issued financial statements similar to those generally applicable to reporting an accounting change retrospectively. Therefore, the reporting of a correction of an error by restating previously issued financial statements is also addressed by SFAS 154. SFAS 154 is required to be adopted in fiscal years beginning after December 15, 2005. The Company does not believe its adoption of SFAS 154 will have a material impact on its consolidated financial position, results of operations or cash flows.

3. Inventory:

Inventory consists of the following:

	December 31,	
	2005	**2004**
Raw materials	$ 22,994,000	$ 12,316,000
Work-in-progress	1,132,000	1,541,000
Finished goods	14,938,000	6,485,000
	39,064,000	20,342,000
Valuation allowances	(1,956,000)	(1,340,000)
	$ 37,108,000	$ 19,002,000

4. Furniture, Fixtures and Equipment:

Furniture, fixtures and equipment consist of the following:

	December 31,	
	2005	**2004**
Furniture and fixtures	$ 339,000	$ 314,000
Equipment	28,361,000	24,561,000
	28,700,000	24,875,000
Accumulated depreciation and amortization	(20,469,000)	(18,729,000)
	$ 8,231,000	$ 6,146,000

For the years ended December 31, 2005, 2004 and 2003, the Company recorded fixed asset depreciation expense of approximately $2,785,000, $3,161,000 and $3,418,000, respectively.

5. Accrued Liabilities

Accrued Liabilities consisted of the following as of:

	December 31, 2005	December 31, 2004
Payroll costs	$ 3,423,000	$ 2,837,000
Marketing Program Costs	2,148,000	1,079,000
Other	1,624,000	1,512,000
Total	$ 7,195,000	$ 5,428,000

6. Discontinued Operations

In January 2002, the Company acquired substantially all the assets, including intellectual property, of Irvine Networks, LLC, a development stage enterprise, for $2.3 million in cash. The Company retained the engineering staff of Irvine Networks, LLC, which was subsequently renamed the Xiran Division. Approximately $1.6 million of the purchase price was attributed to IPR&D and was expensed at the date of acquisition as the IPR&D projects had not reached technological feasibility nor had any alternative use. In addition, approximately $620,000 and $115,000 of the purchase price was allocated to intangible assets and fixed assets, respectively.

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In June 2004, the Company discontinued the operation of its Xiran Division. The loss from discontinued operations in the first quarter of 2004 was $2.4 million. In the second quarter of 2004, in addition to the $1.7 million loss from operations of the discontinued Xiran Division, the Company took a charge of approximately $3.0 million that included a $1.5 million write-off of inventory, an $802,000 write-off reflecting the net book value of Xiran Division fixed assets that will no longer be used, a $310,000 write-off of the net book value of the intangible asset recorded at the date of acquisition, a $173,000 lease impairment charge related to the Xiran Division office space that will no longer be used, $102,000 in severance costs of Xiran Division employees who are no longer employed by the Company, and approximately $51,000 in other charges. Monthly rent on the Xiran Division office lease, which expired on June 30, 2005, was approximately $22,000. In calculating the lease impairment charge, the Company reduced the total lease liability by the estimated fair market value of sublease rental income.

7. Intangible Assets

The following table presents detail of the Company s Intangible assets, related accumulated amortization and goodwill:

	As of December 31, 2005			As of December 31, 2004		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Developed technology (five years)	$ 400,000	$ 107,000	$ 293,000	$ 400,000	$ 27,000	$ 373,000
Customer relationships (five years)	900,000	157,000	743,000			
Total	$ 1,300,000	$ 264,000	$ 1,036,000	$ 400,000	$ 27,000	$ 373,000
Goodwill	$ 733,000	$ 0	$ 733,000	$ 0	$ 0	$ 0

In accordance with SFAS 142, Goodwill and Other Intangible Assets, goodwill and other intangible assets with indeterminate lives are not subject to amortization but are tested for impairment annually or whenever events or changes in circumstances indicate that the asset might be impaired. The Company completed its annual goodwill impairment analysis during each of the years ended December 31, 2005 and 2004, and determined that no adjustment to the carrying value of goodwill was required. Intangible assets with finite lives continue to be subject to amortization, and any impairment is determined in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The Company recorded amortization expense for the years ended December 31, 2005, 2004 and 2003 of $237,000, $89,000 and $124,000, respectively. Estimated intangible asset amortization expense (based on existing intangible assets) for the years ending December 31, 2006, 2007, 2008 and 2009 is $245,000, $245,000, $245,000, and $218,000, respectively. Amortization is complete as of the end of 2010.

8. Acquisition

On July 13, 2005, the Company completed the acquisition of Memtech SSD, Corporation (Memtech), a provider of ultra-rugged and reliable solid state Flash drives, for approximately $2,050,000 in cash and $98,000 in transaction costs directly attributable to the acquisition. The acquisition expanded the Company s presence in the solid-state Flash drive market.

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The acquisition was accounted for as a purchase under SFAS 141, Business Combinations. The final allocation of the excess of the purchase price over the estimated fair value of the net tangible assets acquired is included in identifiable intangibles and goodwill as follows:

Cash	$ 587,000
Accounts receivable	483,000
Inventory	616,000
Other current assets	18,000
Accounts payable	(136,000)
Accrueds and other liabilities	(215,000)
Note payable	(496,000)
Fair value of tangible assets acquired	857,000
Intangible assets Memtech customer list	900,000
Deferred income taxes	(342,000)
Goodwill	733,000
Consideration	$ 2,148,000

The intangible assets are amortized over five years.

9. Income Taxes:

The provision (benefit) for income taxes consists of the following:

	December 31,		
	2005	2004	2003
Current			
Federal	$ 1,234,000	$ 311,000	$ 1,187,000
State	(69,000)	919,000	242,000
Foreign	(45,000)	101,000	(124,000)
	1,120,000	1,331,000	1,305,000
Deferred			
Federal	745,000	1,755,000	(2,563,000)
State	(152,000)	(951,000)	(695,000)
	593,000	804,000	(3,258,000)
Total provision (benefit) for income taxes	$ 1,713,000	$ 2,135,000	$ (1,953,000)

The provision (benefit) from continuing operations for income taxes differs from the amount that would result from applying the federal statutory rate as follows:

	December 31,		
	2005	2004	2003
Statutory regular federal income tax	35.0%	35.0%	35.0%
State taxes, including state tax credits net of federal benefit	(0.4)	3.1	2.5

Federal tax credits	(5.1)	(2.1)	(1.9)
Permanent differences	(2.9)	0.3	0.8
Other, including benefits related to the resolution of federal and state audits	(3.1)	0.7	(4.4)
	23.5%	37.0%	32.0%

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The (benefit) provision for income taxes applicable to continuing operations and discontinued operations consists of the following:

	December 31,		
	2005	2004	2003
Provision for income taxes from continuing operations:			
Current	$ 1,120,000	$ 4,036,000	$ 1,309,000
Deferred	593,000	1,122,000	336,000
Total provision for income taxes from continuing operations	1,713,000	5,158,000	1,645,000
Benefit for income taxes from discontinued operations:			
Current		(2,705,000)	
Deferred		(318,000)	(3,598,000)
Total benefit for income taxes from discontinued operations		(3,023,000)	(3,598,000)
Total income tax expense (benefit)	$ 1,713,000	$ 2,135,000	$ (1,953,000)

The components of deferred tax assets and (liabilities) are as follows:

	December 31,	
	2005	2004
Current deferred tax assets (liabilities):		
Accounts receivable and inventory reserves	$ 890,000	$ 1,179,000
Accrued expenses	514,000	300,000
Other	6,000	36,000
Total current	1,410,000	1,515,000
Noncurrent deferred tax assets (liabilities):		
Depreciation and amortization	43,000	(870,000)
Accelerated stock options	60,000	
Operating loss carryforwards	2,247,000	1,787,000
Credit carryforwards	3,792,000	5,105,000
Capital loss carryforwards	89,000	103,000
State taxes	(1,456,000)	(1,416,000)
Other	(13,000)	14,000
	4,762,000	4,723,000
Valuation allowance	(2,247,000)	(1,378,000)
Total noncurrent	2,515,000	3,345,000
	$ 3,925,000	$ 4,860,000

At December 31, 2005, the Company had the following state credits: research and development credit carryforwards of approximately $2.4 million, which carryforward indefinitely, and enterprise zone credit carryforwards of approximately $1.9 million, which carryforward indefinitely.

At December 31, 2005 and 2004, the Company had U.K. net operating loss carryforwards of $7.3 million and $4.5 million, respectively. The losses carryover indefinitely, unless certain changes in business operations, as defined, occur during the carryover period. The Company has

established a valuation allowance against these deferred tax assets since management believes that it is most likely that this foreign entity s U.K. net operating loss carryforwards will not be fully utilized. The change in valuation allowance is $869,000 for 2005.

The Company has not provided for U.S. taxes or foreign withholding taxes on approximately $98,000 of undistributed earnings from its foreign subsidiaries because such earnings are to be reinvested indefinitely. If these earnings were distributed, foreign tax credits may become available under current law to reduce the resulting U.S. income tax liability.

10. Commitments and Contingencies:

Lemelson Medical, Education & Research Foundation, LLP Patent Infringement

The Company received notice on November 26, 2001 that the Lemelson Medical, Education & Research Foundation, LLP (Lemelson Foundation) filed a complaint on November 13, 2001 against the Company and other defendants. The complaint was filed in the District Court of Arizona and alleges that the Company s manufacturing processes infringe several patents

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that the Lemelson Foundation allegedly owns. The complaint also states that these allegedly infringed patents relate to machine vision technology and bar coding technology. On March 7, 2002, the Company was served with the Lemelson Foundation complaint. Thereafter, the case was stayed pending the outcome of related cases against other parties involving the same patents. On September 9, 2005, in one of these related cases, the U.S. Court of Appeals for the Federal Circuit affirmed a decision by the U.S. District Court for the District of Nevada that found several Lemelson Foundation patents to be unenforceable. Because the final outcome of the related cases are expected to affect the Lemelson Foundation s lawsuit against the Company, an estimate of potential damages, if any, would be premature and speculative. The Company believes this lawsuit is without merit and it intends to vigorously defend itself against it.

Other Legal Proceedings

The Company is currently not a party to any other material legal proceedings. However, the Company is involved in other suits and claims in the ordinary course of business, and the Company may from time to time become a party to other legal proceedings arising in the ordinary course of business.

As is common in the industry, the Company currently has in effect a number of agreements in which the Company has agreed to defend, indemnify and hold harmless certain of its suppliers and customers from damages and costs which may arise from the infringement by the Company s products of third-party patents, trademarks or other proprietary rights. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorneys fees. The Company s insurance does not cover intellectual property infringement.

Lease Commitments

As discussed in Note 12, the Company leases the majority of its corporate office facilities from affiliates of Manouch Moshayedi, Mike Moshayedi and Mark Moshayedi, each of whom is an executive officer, director and major shareholder of the Company. The Company also leases a number of small facilities in both foreign and domestic locations for its additional sales, research and development and engineering staff and for storage from unaffiliated third parties under operating leases with initial noncancelable lease terms ranging from 2 to 4 years. Future scheduled minimum annual lease payments for the years ending December 31 are as follows:

	Operating Leases (Related Party)	Operating Leases (Third Party)
2006	$ 599,853	$ 511,136
2007	599,853	435,817
2008	599,853	153,536
2009	599,853	66,347
2010	599,853	31,884
Thereafter	3,949,032	0
Net minimum lease payments	$ 6,948,297	$ 1,198,720

Rent expense for the years ended December 31, 2005, 2004 and 2003 was approximately $1,148,000, $1,113,000 and $1,009,000, respectively, inclusive of related party balances.

Repurchase Agreements

The Company is contingently liable at December 31, 2005, to various financial institutions for repurchase agreements in connection with wholesale inventory financing. In general, inventory would be repurchased by the Company upon customer default with a financing institution and then resold through normal distribution channels. The amount of potential product returns is estimated and provided for in the period of the sale for financial reporting purposes. As of December 31, 2005, the Company has never been required to repurchase inventory in connection with the customer default agreements noted above. However, there can be no assurance that the Company will not be required to repurchase

inventory, upon customer default, in the future. Sales under such agreements were approximately $1,300,000, $1,100,000 and $1,200,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

401(k) Plan

The Company has a 401(k) profit sharing plan covering employees with at least six months of service. Employees may make voluntary contributions of up to 20% of their annual pre-tax compensation to the plan, subject to the maximum limit allowed

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by the IRS guidelines. The Company makes matching contributions equal to one-half of each participating employee s matchable contributions to the plan, which cannot exceed 10% of their salary. The Company s matching contributions to the plan are subject to vesting at the rate of 20% per year beginning after the employee s second year of employment. For the years ended December 31, 2005, 2004 and 2003, the Company made matching contributions of approximately $581,000, $589,000 and $506,000, respectively.

11. Stock Option Plan:

The 2000 Stock Incentive Plan (the Plan) was adopted by the Company s board of directors and approved by its shareholders in June 2000. The Plan provides for the direct sale of shares and the grant of options to purchase shares of the Company s common stock to officers and other employees, non-employee board members and consultants. Under the Plan, eligible participants may be granted options to purchase shares of common stock at an exercise price not less than 100% of the fair market value of those shares on the grant date. The compensation committee of the Company s board of directors has the authority to determine the time or times at which options become exercisable under the Plan. Options expire within a period of not more than ten years from the date of grant.

At December 31, 2005, the Plan provided for the issuance of up to 1,495,941 shares of common stock. The number of shares of common stock reserved for issuance under the Plan will automatically increase on the first trading day in January in each calendar year by an amount equal to 4% of the total number of shares of common stock outstanding on the last trading day in December of the prior calendar year, but in no event will exceed 2,500,000 shares.

A summary of the option activity under the Plan is as follows:

	Shares Under Option	Average Exercise Price
Balances at 12/31/02	6,753,652	$ 4.05
Granted	3,854,600	$ 3.82
Exercised	(854,792)	$ 1.53
Canceled/ forfeited	(761,165)	$ 4.47
Balances at 12/31/03	8,992,295	$ 4.13
Granted	2,038,700	$ 4.23
Exercised	(419,964)	$ 2.37
Canceled/ forfeited	(2,023,167)	$ 4.81
Balances at 12/31/04	8,587,864	$ 4.09
Granted	3,275,000	$ 4.38
Exercised	(551,956)	$ 2.02
Canceled/ forfeited	(858,020)	$ 4.57
Balances at 12/31/05	10,452,888	$ 4.25
Exercisable at 12/31/03	2,325,689	$ 3.60
Exercisable at 12/31/04	3,267,903	$ 4.06
Exercisable at 12/31/05	10,452,888	$ 4.25

At December 31, 2005, 1,495,941 options were available for grant under the Plan.

Range of	Options Outstanding			Exercisable	

Exercise Prices	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (Years)	Number of Shares	Weighted Average Exercise Price
$1.06 to $ 2.20	651,939	$ 1.14	0.88	651,939	$ 1.14
$2.20 to $ 3.30	2,557,503	3.00	7.01	2,557,503	3.00
$3.30 to $ 5.50	4,382,552	3.98	8.35	4,382,552	3.98
$5.50 to $ 6.60	2,017,494	5.78	6.40	2,017,494	5.78
$6.60 to $11.00	843,400	8.13	8.05	843,400	8.13
	10,452,888			10,452,888	

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The weighted average grant date fair value per share of shares under option was $2.27, $1.99 and $1.72 for the years ended December 31, 2005, 2004 and 2003, respectively.

The Company s board of directors approved the accelerated vesting of all currently outstanding unvested stock options previously awarded to employees, consultants, officers and directors as of December 19, 2005. The purpose of the accelerated vesting of unvested stock options is to enable the Company to reduce compensation expense associated with these options in future periods upon the Company s adoption of SFAS 123(R) on January 1, 2006. As a result of the accelerated vesting, unvested stock options to purchase approximately 5.6 million shares became exercisable, representing 56% of the Company s total outstanding stock options as of December 19, 2005. These unvested stock options consist of both in-the-money as well as out-of-the-money options. Based upon the closing price of SimpleTech common stock of $3.79 per share on December 19, 2005, approximately 47% of the total accelerated stock options are in-the-money with a weighted average exercise price of $3.20 per share. Of the accelerated stock options, options to purchase approximately 1.6 million shares of common stock are held by executive officers and non-employee directors (of which options to purchase 895,000 shares of common stock are in-the-money). Based on the closing price of SimpleTech common stock on December 19, 2005, the Company s historical employee turnover rates and estimate of future employee separation, the Company incurred a non-cash stock charge of approximately $374,000 as a result of the accelerated vesting in the fourth quarter of 2005.

No compensation expense was recorded as a result of stock options granted to employees in the years ended December 31, 2004 and 2003 as the fair market value approximated the per share exercise price of the respective options granted.

12. Related Party Transactions:

The Company occupies two leased facilities of approximately 24,500 and 48,600 square feet in Santa Ana, California, which serves as its corporate headquarters. In addition to the Company s executive offices, these facilities also contain substantially all of the Company s manufacturing, engineering, research and development and testing operations. The Company leases both facilities from MDC Land LLC (MDC), a limited liability company owned by Manouch Moshayedi, Mike Moshayedi and Mark Moshayedi, each of whom is an executive officer, director and major shareholder of SimpleTech. MDC has no operations other than leasing transactions with the Company.

An operating lease with MDC for the 24,500 square foot facility expires in July 2017. The monthly base rent was approximately $17,000 per month through July 31, 2005. Effective August 1, 2005, the base rent was adjusted to approximately $18,000 per month as a result of an appraisal of the current market value performed as required by the lease. This lease expires in July 2017. Beginning August 1, 2007, and for the remainder of the lease, base rent shall be adjusted every two years based on the change in the Consumer Price Index.

An operating lease with MDC for the 48,600 square foot facility expires in July 2017. The monthly base rent was approximately $33,000 per month through July 31, 2005. Effective August 1, 2005, the base rent was adjusted to approximately $32,000 per month as a result of an appraisal of the current market value performed as required by the lease. This lease expires in July 2017. Beginning August 1, 2007, and for the remainder of the lease, base rent shall be adjusted every two years based on the change in the Consumer Price Index.

Building rent expense for these two facilities amounted to $600,000, $603,000 and $603,000 for each of the years ended December 31, 2005, 2004 and 2003, respectively. At December 31, 2005, 2004 and 2003, there was no outstanding facility rent owed to MDC.

In 2005, 2004 and 2003, the Company purchased $45,000, $57,000 and $66,000, respectively, in testing services from QualCenter, Inc., a Texas S Corporation company beneficially owned by Manouch Moshayedi, Mike Moshayedi and Mark Moshayedi. QualCenter is located in Houston, Texas and performs tests and qualification services on Hewlett-Packard desktop, laptop, server, and workstation memory modules. QualCenter performs these services on an exclusive basis for Hewlett-Packard under an arrangement whereby Hewlett-Packard defines and specifies all test and evaluation procedures and methodologies.

13. Segment Information:

The Company reports financial results for two reportable operating segments, its OEM and Consumer Divisions. The Company does not aggregate any operating segments.

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The accounting policies for each of the reportable operating segments are the same as those described in Note 2 and reflect the information used by the Company s management to evaluate the performance of its segments. For the OEM and Consumer segments, the Company tracks separately net sales and gross profit but does not track separately operating expenses. The Company does not maintain separate records to identify assets by operating segment.

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Summarized financial information regarding the Company s two reportable segments is shown in the following table:

	Year Ended December 31, 2005		
	Net Revenues	Cost of Revenues	Gross Profit
Consumer:			
Standard Memory	$ 60,644,000	$ 53,119,000	$ 7,525,000
Flash Memory	32,291,000	28,598,000	3,693,000
Stacked Memory	5,568,000	4,335,000	1,233,000
Hard Drive	35,175,000	29,557,000	5,618,000
	$ 133,678,000	$ 115,609,000	$ 18,069,000
OEM:			
Standard Memory	$ 22,632,000	$ 17,758,000	$ 4,874,000
Flash Memory	37,578,000	22,311,000	15,267,000
Stacked Memory	67,348,000	56,756,000	10,592,000
Other	752,000	453,000	299,000
	$ 128,310,000	$ 97,278,000	$ 31,032,000
Total:			
Standard Memory	$ 83,276,000	$ 70,877,000	$ 12,399,000
Flash Memory	69,869,000	50,909,000	18,960,000
Stacked Memory	72,916,000	61,091,000	11,825,000
Raw/other	35,927,000	30,010,000	5,917,000
	$ 261,988,000	$ 212,887,000	$ 49,101,000

	Year Ended December 31, 2004		
	Net Revenues	Cost of Revenues	Gross Profit
Consumer:			
Standard Memory	$ 79,973,000	$ 67,216,000	$ 12,757,000
Flash Memory	39,611,000	35,984,000	3,627,000
Stacked Memory	9,762,000	7,705,000	2,057,000
Hard Drive	14,390,000	11,231,000	3,159,000
	$ 143,736,000	$ 122,136,000	$ 21,600,000
OEM:			
Standard Memory	$ 12,546,000	$ 10,508,000	$ 2,038,000
Flash Memory	22,586,000	13,416,000	9,170,000
Stacked Memory	95,155,000	81,394,000	13,761,000
Other	1,409,000	815,000	594,000
	$ 131,696,000	$ 106,133,000	$ 25,563,000
Total:			
Standard Memory	$ 92,519,000	$ 77,724,000	$ 14,795,000
Flash Memory	62,197,000	49,400,000	12,797,000
Stacked Memory	104,917,000	89,099,000	15,818,000
Raw/other	15,799,000	$ 12,046,000	3,753,000

	$ 275,432,000	$ 228,269,000	$ 47,163,000

	Year Ended December 31, 2003		
	Net Revenues	Cost of Revenues	Gross Profit
Consumer:			
Standard Memory	$ 74,474,000	$ 64,498,000	$ 9,976,000
Flash Memory	60,148,000	51,681,000	8,467,000
Stacked Memory	7,861,000	6,208,000	1,653,000
Hard Drive	10,899,000	7,961,000	2,938,000
	$ 153,382,000	$ 130,348,000	$ 23,034,000
OEM:			
Standard Memory	$ 8,712,000	$ 7,157,000	$ 1,555,000
Flash Memory	20,102,000	14,024,000	6,078,000
Stacked Memory	26,304,000	21,907,000	4,397,000
Other	3,306,000	2,491,000	815,000
	$ 58,424,000	$ 45,579,000	$ 12,845,000
Total:			
Standard Memory	$ 83,186,000	$ 71,655,000	$ 11,531,000
Flash Memory	80,250,000	65,705,000	14,545,000
Stacked Memory	34,165,000	28,115,000	6,050,000
Raw/other	14,205,000	10,452,000	3,753,000
	$ 211,806,000	$ 175,927,000	$ 35,879,000

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For the years ended December 31, 2005, 2004 and 2003, international sales comprised 13%, 18% and 19% of the Company s revenues, respectively. During these periods, no single foreign country accounted for more than 10% of total revenues. Substantially all of the Company s international sales are export sales, which are shipped from the Company s domestic facility to foreign customers.

14. Selected Quarterly Financial Data (unaudited):

Quarter Ended:	December 31, 2005	September 30, 2005	June 30, 2005	March 31, 2005
Net revenues	$ 63,251	$ 67,221	$ 70,268	$ 61,247
Gross profit	11,418	13,908	12,791	10,983
Operating (loss) income	(107)	2,472	2,055	1,238
Net income	763	1,840	1,935	1,036
Net income per share:				
Basic	$ 0.02	$ 0.04	$ 0.04	$ 0.02
Diluted	$ 0.02	$ 0.04	$ 0.04	$ 0.02

Quarter Ended:	December 31, 2004	September 30, 2004	June 30, 2004	March 31, 2004
Net revenues	$ 77,616	$ 75,016	$ 56,509	$ 66,291
Gross profit	13,926	13,451	8,261	11,525
Operating income	4,367	4,820	1,000	2,700
Income from continuing operations	3,180	3,073	855	1,673
Income (loss) from discontinued operations	10		$ (2,728)	$ (1,374)
Net income (loss)	$ 3,190	$ 3,073	$ (1,873)	$ 299
Net income per share:				
Basic:				
Continuing operations	$ 0.07	$ 0.06	$ 0.02	$ 0.04
Discontinued operations			$ (0.06)	$ (0.03)
Total	$ 0.07	$ 0.06	$ (0.04)	$ 0.01
Diluted				
Continuing operations	$ 0.06	$ 0.06	$ 0.02	$ 0.03
Discontinued operations			$ (0.06)	$ (0.02)
Total	$ 0.06	$ 0.06	$ (0.04)	$ 0.01

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL

STATEMENT SCHEDULE

To the Board of Directors of

SimpleTech, Inc.

Our audits of the consolidated financial statements referred to in our report dated March 29, 2006 appearing in the 2005 Annual Report on Form 10-K of SimpleTech, Inc. also included an audit of the consolidated financial statement schedule listed in Item 15(a)(2) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers LLP

Orange County, California

March 29, 2006

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SIMPLETECH, INC.

Schedule II Valuation and Qualifying Accounts and Reserves

For the Years Ended December 31, 2003, 2004 and 2005

	Accounts Receivable Allowances	Inventory Valuation Allowances
Balance, December 31, 2002	$ 782,000	$ 804,000
Charged to operations	2,164,000	367,000
Write-offs	(1,817,000)	(128,000)
Balance, December 31, 2003	1,129,000	1,043,000
Charged to operations	1,156,000	1,142,000
Write-offs	(1,292,000)	(845,000)
Balance, December 31, 2004	993,000	1,340,000
Charged to operations	998,000	1,361,000
Write-offs	(1,113,000)	(745,000)
Balance, December 31, 2005	$ 878,000	$ 1,956,000

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Santa Ana, State of California, on the 29th day of March, 2006.

SimpleTech, Inc.

By: /s/ Manouch Moshayedi
Name: Manouch Moshayedi
Title: Chief Executive Officer and
Chairman of the Board of Directors

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Manouch Moshayedi	Chief Executive Officer and	March 29, 2006
Manouch Moshayedi	Chairman of the Board of Directors	
/s/ Mike Moshayedi	President and Director	March 29, 2006
Mike Moshayedi		
/s/ Mark Moshayedi	Chief Operating Officer, Chief	March 29, 2006
Mark Moshayedi	Technical Officer, Secretary and	
	Director	
/s/ Dan Moses	Chief Financial Officer (Principal	March 29, 2006
Dan Moses	Financial and Accounting Officer)	
	and Director	
/s/ F. Michael Ball	Director	March 29, 2006
F. Michael Ball		
/s/ Rajat Bahri	Director	March 29, 2006
Rajat Bahri		
/s/ James J. Peterson	Director	March 29, 2006
James J. Peterson		

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EXHIBIT INDEX

Number	Description	Location
3.1	Amended and Restated Articles of Incorporation	Exhibit 3.1 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 3, 2000.
3.1.1	Certificate of Amendment to the Amended and Restated Articles of Incorporation, dated August 31, 2000	Exhibit 3.3 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed September 27, 2000.
3.1.2	Certificate of Amendment to the Amended and Restated Articles of Incorporation, dated May 1, 2001.	Exhibit 3.1 to the Quarterly Report on Form 10-Q of the registrant for the quarter ended March 31, 2001, filed May 14, 2001.
3.2	Amended and Restated Bylaws	Exhibit 3.2 to the Registration Statement on Form S-1 (File No. 333-32478) of the registrant, filed March 15, 2000.
4.1	See Exhibits 3.1 and 3.2 for provisions of the Articles of Incorporation and Bylaws for SimpleTech, Inc. defining the rights of holders of common stock of SimpleTech, Inc.	
4.2	Specimen Stock Certificate	Exhibit 4.2 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 28, 2000.
10.1	Amended and Restated Real Estate Lease, dated April 1, 2000, by and between MDC Land LLC and SimpleTech, Inc.	Exhibit 10.1 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 3, 2000.
10.2	Amended and Restated Real Estate Lease, dated June 1, 2000, by and between MDC Land LLC and SimpleTech, Inc.	Exhibit 10.2 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 3, 2000.
10.3	2000 Stock Incentive Plan (as amended and restated)	Exhibit 99.1 to the Registration Statement on Form S-8 (File No. 333-124387) of the registrant, filed April 28, 2005.
10.4	Form of Indemnification Agreement between SimpleTech, Inc. and each of its directors and officers	Exhibit 10.7 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 3, 2000.
10.5	Form of Employment Agreement for Executive Officers of SimpleTech, Inc. (including a schedule of substantially identical agreements)	Exhibit 10.8 to the Registration Statement on Form S-1 (File No. 333-32478) of the registrant, filed March 15, 2000.
10.6	Distribution and Tax Indemnity Agreement, dated September 26, 2000, by and between SimpleTech, Inc. and each of the shareholders of SimpleTech, Inc.	Exhibit 10.9 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed July 28, 2000.
10.7	License Agreement, dated August 22, 2000, by and between Micron Electronics and SimpleTech, Inc.	Exhibit 10.25 to the Registration Statement on Form S-1/A (File No. 333-32478) of the registrant, filed September 6, 2000.
10.8	Amendment No. 1 to Amended and Restated Real Estate Lease, dated April 29, 2002, by and between MDC Land, LLC and SimpleTech, Inc. (24,500 sq. ft. facility)	Exhibit 10.10 to the Registration Statement on Form S-1/A (File No. 333-109372) of the registrant, filed October 15, 2003.
10.9	Amendment No. 1 to Amended and Restated Real Estate Lease, dated April 29, 2002, by and between MDC Land, LLC and SimpleTech, Inc. (48,600 sq. ft. facility)	Exhibit 10.11 to the Registration Statement on Form S-1/A (File No. 333-109372) of the registrant, filed October 15, 2003.

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10.10	Description of Compensatory Arrangements for 2005 Applicable to Named Executive Officers	Exhibit 10.12 to the Annual Report on Form 10-K of the registrant for the year ended December 31, 2004, filed March 16, 2005.
10.11	Summary of Non-Employee Director Compensation Arrangements	Exhibit 99.1 to the Current Report on Form 8-K filed October 20, 2005.
21.1	List of Subsidiaries of SimpleTech, Inc.	Filed herewith.
23.1	Consent of PricewaterhouseCoopers LLP	Filed herewith.
31.1	Section 302 Certification of Chief Executive Officer	Filed herewith.
31.2	Section 302 Certification of Chief Financial Officer	Filed herewith.
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Furnished herewith pursuant to SEC Release No. 33-8238.
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Furnished herewith pursuant to SEC Release No. 33-8238.

Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(c) of Form 10-K.

* The information in Exhibits 32.1 and 32.2 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or otherwise subject to the liabilities of that section, nor shall they be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act (including this Report), unless SimpleTech, Inc. specifically incorporates the foregoing information into those documents by reference.