The Fruit of Technology

SimpleTech
Annual Report
2004

SimpleTech Designs, manufactures and markets custom and open-standard memory solutions based on Flash memory and dynamic random access memory, or DRAM, technologies. We offer a comprehensive line of more than 2,500 products and specialize in developing high-density memory modules, memory cards and storage drives. One way that we distinguish ourselves in the marketplace is by offering both Flash and DRAM-based solutions used by consumer 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.

Jeremy
Madeleine
Bill
Sam

Jeremy

By popular demand Jeremy's business of Study Buddy (an internet Study Tutor Service) was able to upgrade memory capacity on all his servers which manage, organize and track all of his clients' records. Now he is ready to go international.

Dynamic Random Access Memory (DRAM) is the most common form of computer memory. It needs to be continually refreshed to properly maintain data, and so the term used is "Dynamic." DRAM is faster than other non-dynamic memory.

MPEG Audio Layer 3 (MP3) is an audio compression technology. MP3 makes it possible to download quality audio files from the Internet quickly and easily. Many MP3 Music Systems use Flash chips or Flash cards to permanently store the files.

After trashing more than a hundred exercise and work-out albums, which she downloaded to her upgradeable MP3 music player, Madeleine was able to re-design her living room with all the space left over.

Bill is not only a third grade teacher but also is head of the PTA, Soccer Dads Association, Science for Children of America, and manages his own scented candle business with his expandable PDA and high-capacity Flash memory.

Flash is *non-volatile memory* that retains its content even when electrical current is turned off. *Flash memory is used in many* applications including upgradeable cell phones, MP3 Music Systems and custom *ruggedized* applications for the military.

Sam

External Hard Drives are high-speed, high-capacity drives that enable safe yet readily accessible storage for most applications including digital music, movies, sensitive data files and photographs. Full or incremental backups are executed quickly and easily. With Network Attached Storage (NAS) technology as an additional feature, multiple users in small office or home office can store and share files.

Sam plays tennis, belongs to the school's chess club and see's at least two movies per weekend. She also programs, organizes, archives and manages her family's network of household computers. She uses a 250 gig SimpleShare, with SimpleTech's NAS technology, which allows her to multi-task while chatting online with her friends.

The fruit of technology is what you make of it.

Letter to Shareholders

In the blink of a few decades, technology and all that it impacts have changed rapidly. The rapidity of change has certainly challenged many technology companies – SimpleTech included. Moreover, this dynamic environment has provided technology companies a potential harvest of opportunity – SimpleTech included.

Dear Investors,

The year 2004 was a very challenging, but fruitful year of continued revenue growth, gross profit margin expansion and increased profitability. In 2004, income from continuing operations increased 152%. As a result, we ended 2004 with the strongest balance sheet in our 15-year history.

In the early part of year 2005, we expect to face transitional challenges as we introduce and some of our customers transition to our latest generation of stacked and monolithic memory modules, however, we believe that we can build on our 20% revenue growth in 2003 and 30% revenue growth in 2004.

During the second half of 2004, we carried out a concerted effort to identify, focus on and begin execution of specific growth initiatives which relate directly to and leverage off of our business expertise – memory and external storage. These clearly focused initiatives are designed to continue driving revenue growth and earnings growth. We highlight the following initiatives in a special section on pages 15 through 21 of this Annual Report:

* Capitalizing on the rapidly growing External Storage (HDD) market by introducing new external storage solutions, such as SimpleShare, the Networked Attached Storage (NAS) that we developed and introduced late in year 2004;
* Continuing to innovate next-generation technologies for the military and other markets that require Solid State Flash Drives customized to function in unique and critical environments;
* Expanding our presence in new markets such as the Mobile Phone Retail market to satisfy the increasing memory requirements resulting from expanded cell phone functionality;
* Adding customers for our Value-add OEM DRAM memory solutions, by leveraging our IC Tower stacking technologies which helped us more than double sales in year 2004 for this category; and
* Expanding our international presence through our recently opened offices in Hong Kong and Taiwan, increased the sales and marketing staff of our European sales headquarters in the Netherlands, and potential international co-branding partnerships.

Making the Right Moves

We executed two strategic moves in 2004 that significantly benefited our operating results. First, we exited an unprofitable business. Second, we avoided certain business segments in which we determined that the risk outweighed the potential rewards. These moves enabled us to refocus our attention and invest our capital in the core business, namely in the growth initiatives that I discussed earlier. Such moves helped to strengthen our balance sheet, increased our cash flow and profitability in year 2004. The moves were the result of management's goal to unequivocally refocus and dedicate all of our competencies, resources and attention, including our top technical developers and our management team, to initiatives that are synchronized with and leverage off of our core business expertise in DRAM, Flash memory and external storage solutions.

Stock Repurchase Program

We routinely evaluate the most effective use of our cash to achieve future growth opportunities and provide an attractive return on investment to our shareholders. In June of 2004, our board of directors believed that a share repurchase program was in the best interest of our shareholders and authorized the company to repurchase up to $15 million of its common stock over the next 18 months. The shares may be purchased from time to time at prevailing market prices through open market or unsolicited negotiated transactions, depending on market conditions and other considerations.

Our Employees

SimpleTech's success in year 2004 is the product of an industry-experienced, hard-working, talented group. And I am very proud to be a part of and lead this exceptional group. This group now includes many long-time company veterans and an infusion of very important recent-comers. The result is a definite strengthening of our infrastructure, including our Corporate Development, Business Development and Marketing, New Technology Solutions, and DRAM technology efforts. We are incredibly fortunate to have this dedicated and focused group whose experience, expertise and efforts stand to contribute greatly to SimpleTech's future success.

It is all about the Long-Term Proposition

We believe that a fundamental measure of our success will be the value we create over the long term for our shareholders. This value will be a direct result of our ability to continue building our share of the markets that we compete in. In many cases, this will be done as we add features that distinguish our products. We believe, that the inputs are in place for higher revenue, higher profitability and ultimately value creation. Our actions historically and in year 2004 reflect this long-term focus.

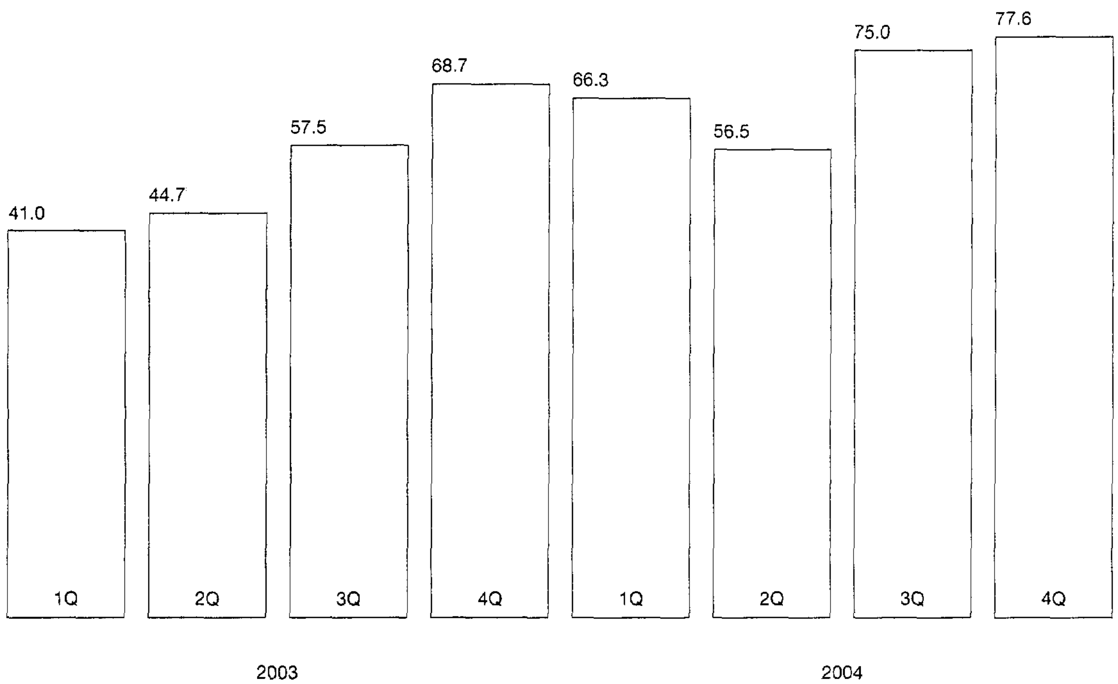
Throughout this letter, I hope you have noticed certain key words referred to repeatedly: focus, initiatives and execution. These words have arisen many more times in management and group meetings during the second half of year 2004 and in the beginning of year 2005. Can we successfully execute our initiatives for 2005? Can we successfully bring to market our new value-add memory and storage solutions? Can we successfully achieve notable growth for a third consecutive year? My management team, board of directors and I are working extremely hard to answer these questions with success. It is an exciting time for our company.

To my fellow shareholders, our customers and suppliers, and of course my colleagues here at SimpleTech, our intent is clear and our efforts keenly focused. It is my sincere hope that at this time next year our discussion would center on how we shared the fruit of growth and successful execution in 2005.
Sincerely,

Manouch Moshayedi
Chief Executive Officer

Quarterly Revenues**

in millions of dollars



Historical Quarterly Operating Performance**

in millions of dollars, except EPS

	2003 Quarterly				2004 Quarterly			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net Revenues	40.9	44.7	57.5	68.7	66.3	56.5	75.0	77.6
Gross Profit %	17.3	17.3	17.1	16.4	17.4	14.6	17.9	17.9
Operating Margin %	(2.4)	1.3	4.3	3.6	4.1	1.8	6.4	5.6
EPS*	(0.01)	0.01	0.04	0.04	0.03	0.02	0.06	0.06

* Earnings Per Diluted Share (EPS) from continued operations

** The graphs above are provided only as a historical reference to SimpleTech, Inc.'s past performance. Historical performance may not be predictive of future performance. Please see our Risk Factors section beginning on page 35 and cautionary language related to forward-looking statements on page 22.

Q&A

ew many investors get or even take advantage of the opportunity to sit down with a company's CEO? We thought you would benefit from this opportunity. Join SimpleTech's Chairman and CEO Manouch Moshayedi for a brief Q & A session.

“ Manouch: SimpleTech is a 15-year-old company that focuses primarily on the DRAM, flash memory and external storage markets. We have been profitable for [illegible] and [illegible] years.

[illegible] Our OEM Division provides [illegible] customized memory solutions [illegible] customers [illegible] memory-related companies. Our OEM Division revenues constitute [illegible] of our sales. Our Consumer Division, which represents [illegible] 50%, [illegible] offers DRAM memory module upgrade solutions for personal computers, notebook computers and servers. It also offers flash memory solutions [illegible] flash memory for digital cameras, expandable [illegible] MP3 [illegible] drives and MP3 music players. ”

“ Manouch: Our balance sheet at the end of 2004 is extremely strong, stronger than ever before. We ended 2004 with more than $80 million in cash and short-term marketable securities and no debt. We have always concentrated on turning our inventory as quickly as possible. We [illegible] about $75 million in sales in the fourth quarter of 2004 and by design reduced our inventory to a very low level, [illegible] million. We also turn our accounts receivable very quickly, averaging [illegible] days. As a result, our balance sheet is extremely solid.

From an income statement perspective, we have experienced significant revenue growth over the past two years, a trend that we are hoping to continue in 2005. We believe, based upon the growth initiatives that we are [illegible] we are in a very strong position to continue that trend, particularly in the second half of year 2005.

[illegible] operating expenses [illegible] General & Administrative and Research & Development expenses are expected to be relatively flat in year 2005. [illegible] incremental revenue, we would expect to [illegible] incremental [illegible] sales and marketing costs of 5% to 7%. Consequently, we have a [illegible] amount of operating leverage in our business model. ”

What is the extent of SimpleTech's analyst coverage?

"Manouch: We understand that about half of the Nasdaq-listed companies have no analyst coverage. For a micro-cap or small-cap company, I believe that we have very good analyst coverage. Today, we are covered by analysts at Lehman Brothers in San Francisco, Needham & Company in New York, Thomas Weisel Partners in New York and B. Riley & Company in St. Louis. Each analyst understands our business, the factors that drive the semiconductor industry, and most importantly the memory sectors that we operate in."

How important is SimpleTech's intellectual property (IP) portfolio?

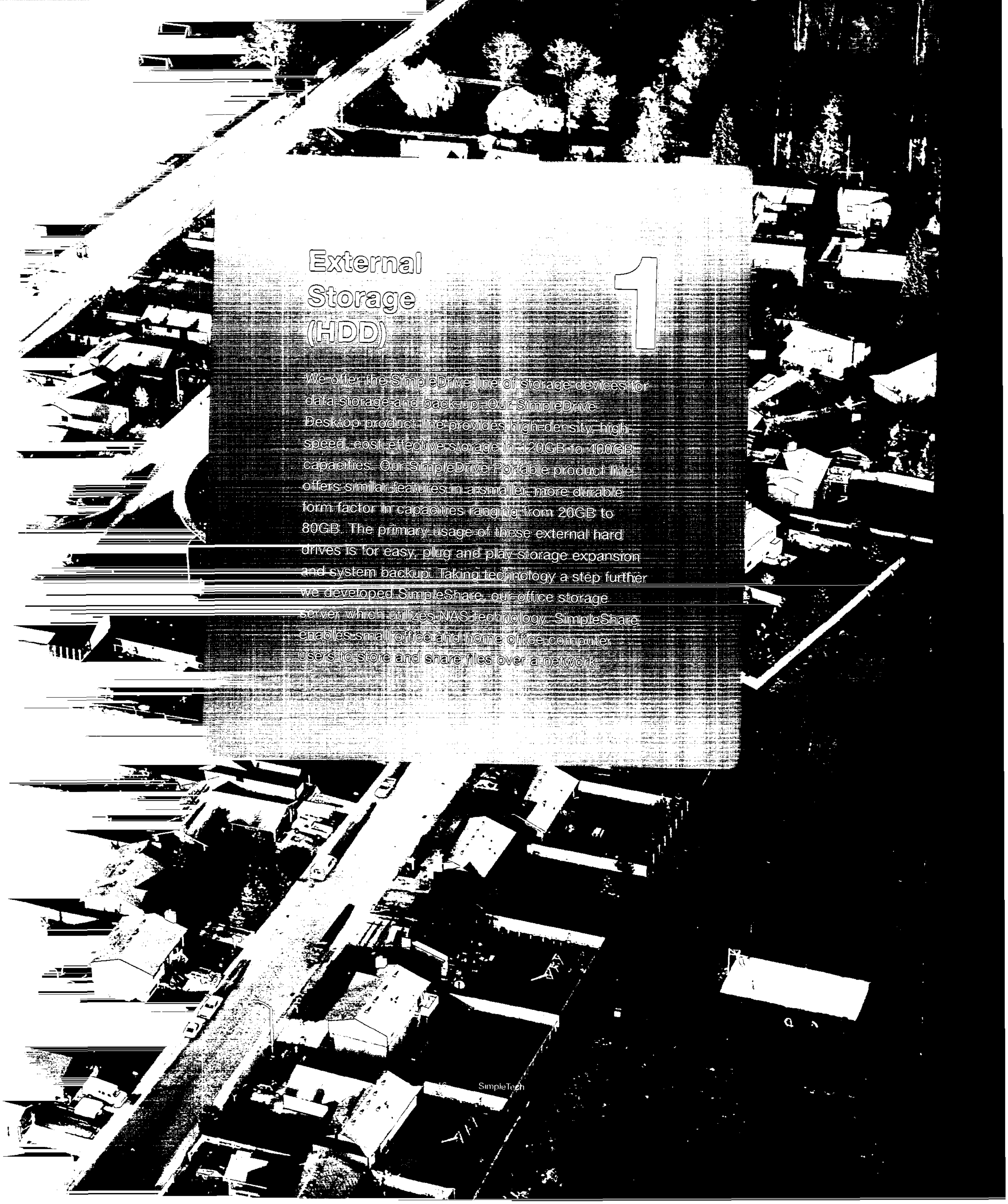
"Manouch: On the OEM side of our business — most of the products are based on patented technologies such as our stacked DRAM modules and Flash products for military, gaming and other applications. Our IP is extremely important. In fact, the primary reason that we generate OEM sales is our ability to customize products for our OEM customers.

The success of the Consumer side of our business is due to relationship-building efforts coupled with execution of delivery, inventory management, and implementing effective marketing programs. Products offered by our Consumer Division include commoditized DRAM upgrades for computing systems and Flash card upgrades for digital cameras, expandable cell phones, and MP3 music players. We believe that we have established a very solid mix of relationship-based business and OEM or technology value-add business."

" Manouch: First of all, I would suggest that you examine our financial position. We are extremely strong from a balance sheet perspective. We are cash flow positive, and we believe that, based on our operating history, we are excellent inventory managers. We ended year 2004 with approximately $80 million in cash and short-term marketable securities. We have been profitable each year except for three years in our 15-year history. And during that three-year period, the losses were nominal. That said, I believe that our business model has proven its effectiveness over the long-term. Our balance sheet provides excellent leverage as we work to execute our growth initiatives. Historically, we have been quick to adapt and successful in weathering storms while building on a valuable base of customers and acquiring valuable industry experience. "

Our Growth Initiatives

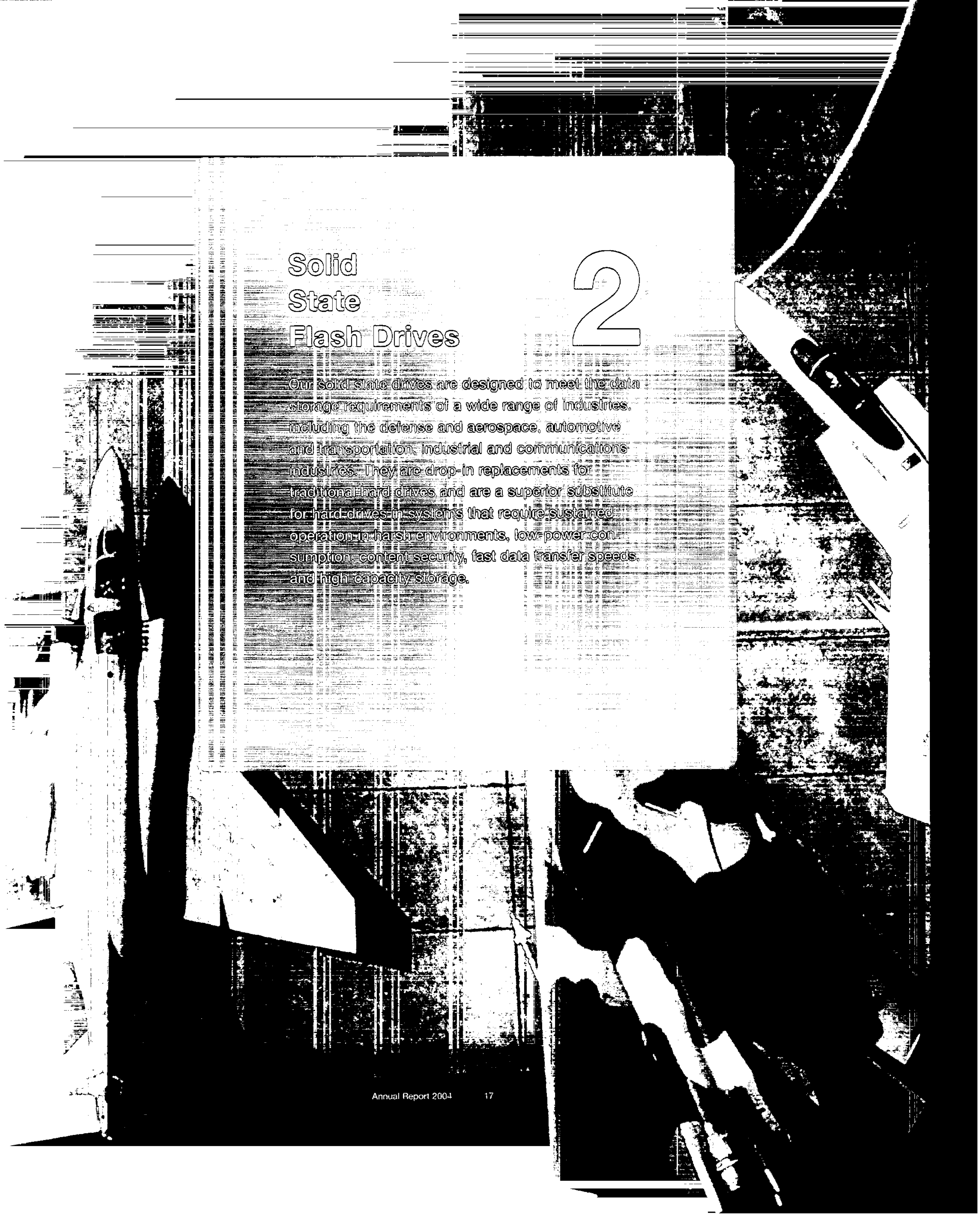
1. External Storage (HDD)
2. Solid State Flash Drives
3. Mobile Phone Retail (Flash)
4. Value-Add on OEM DRAM Solutions
5. International Expansion Efforts



External Storage (HDD)

1

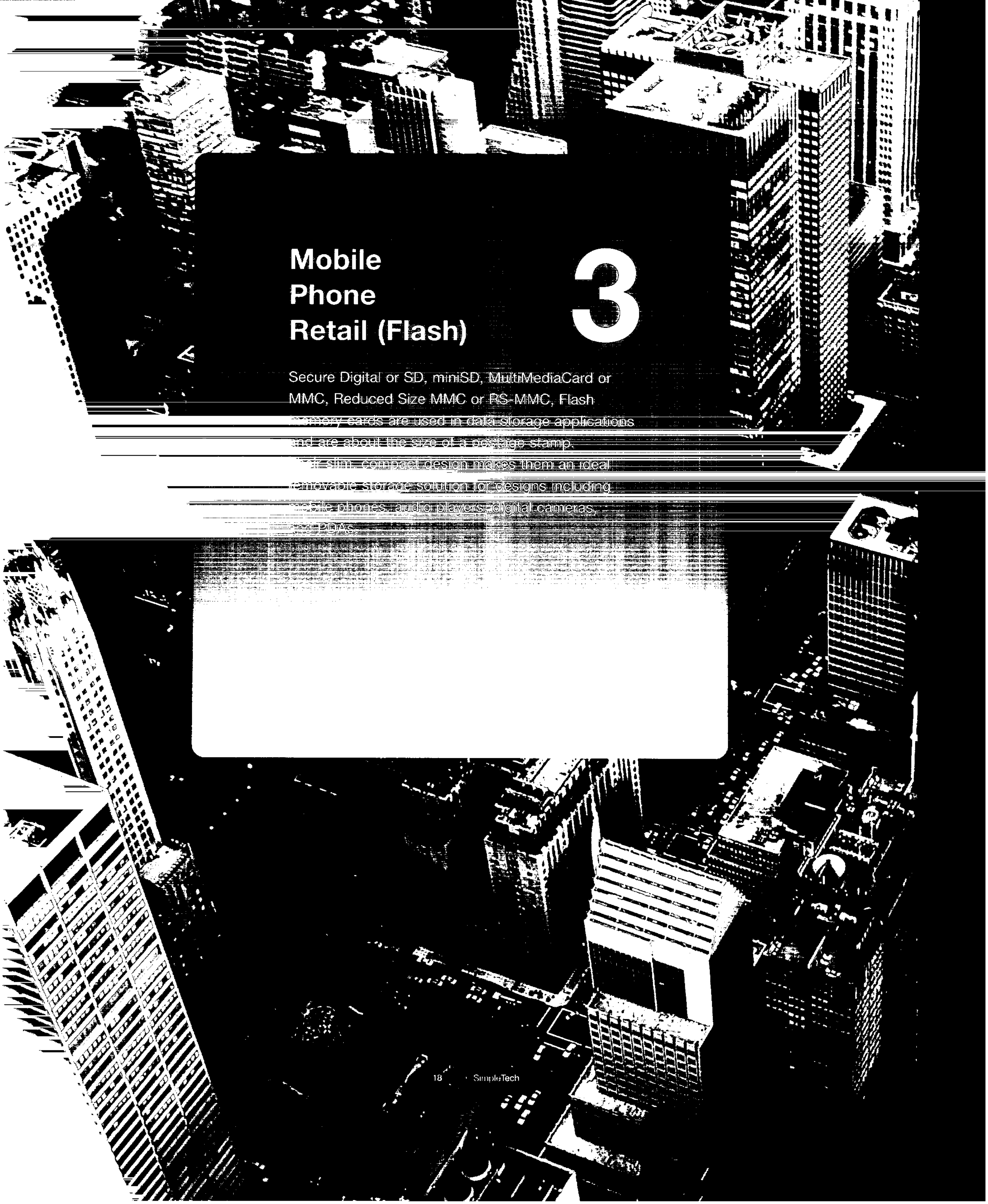
We offer the SimpleDrive line of storage devices for data storage and back-up. Our SimpleDrive Desktop product line provides high-density, high-speed, cost-effective storage in 120GB to 400GB capacities. Our SimpleDrive Portable product line offers similar features in a smaller, more durable form factor in capacities ranging from 20GB to 80GB. The primary usage of these external hard drives is for easy, plug and play storage expansion and system backup. Taking technology a step further we developed SimpleShare, our office storage server which utilizes NAS technology. SimpleShare enables small office and home office computer users to store and share files over a network.



Solid State Flash Drives

2

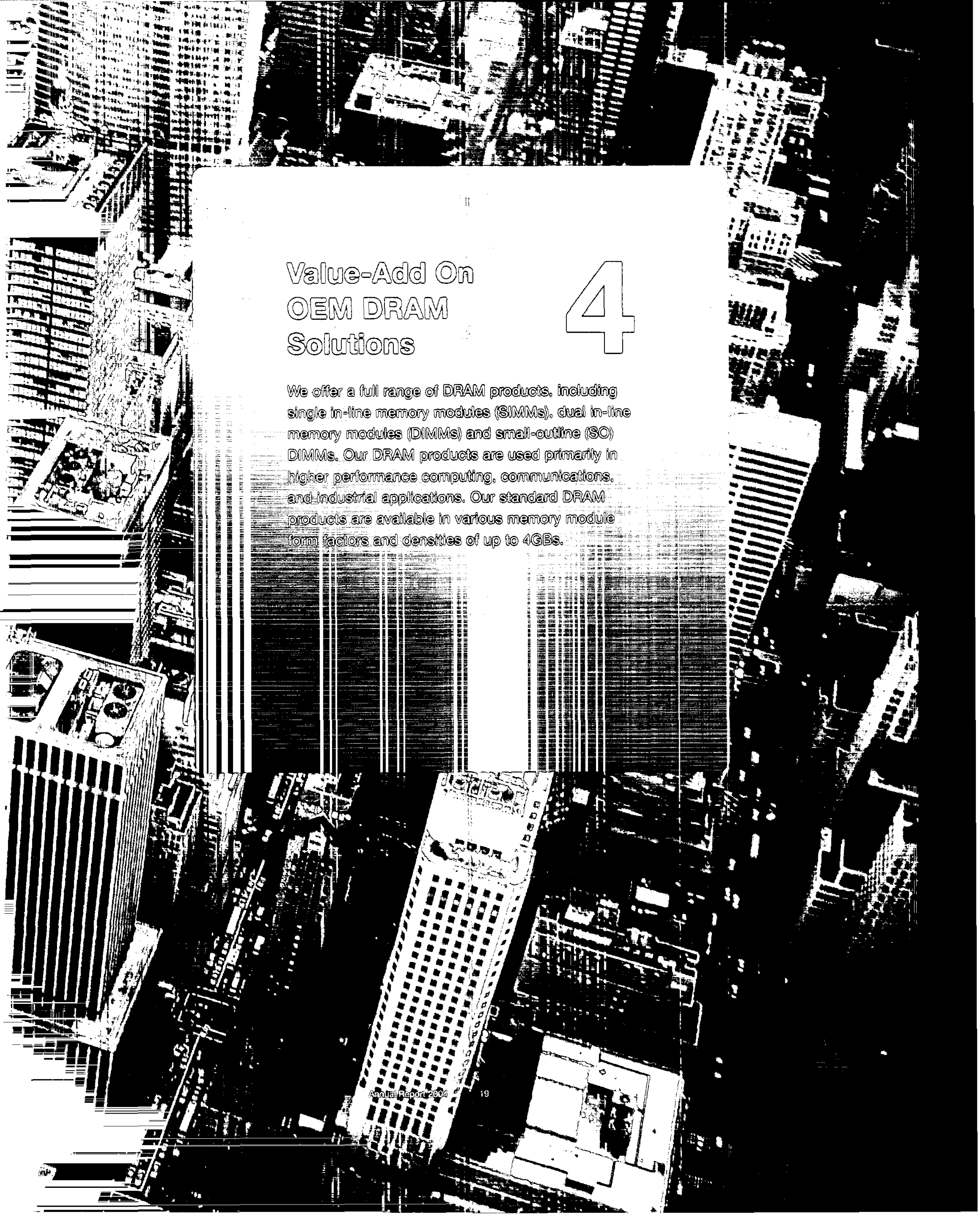
Our solid state drives are designed to meet the data storage requirements of a wide range of industries, including the defense and aerospace, automotive and transportation, industrial and communications industries. They are drop-in replacements for traditional hard drives and are a superior substitute 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.



Mobile Phone Retail (Flash)

3

Secure Digital or SD, miniSD, MultiMediaCard or MMC, Reduced Size MMC or RS-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 PDAs.



Value-Add On OEM DRAM Solutions

4

We offer a full range of DRAM products, including single in-line memory modules (SIMMs), dual in-line memory modules (DIMMs) and small-outline (SO) DIMMs. Our DRAM products are used primarily 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.

International Expansion Efforts

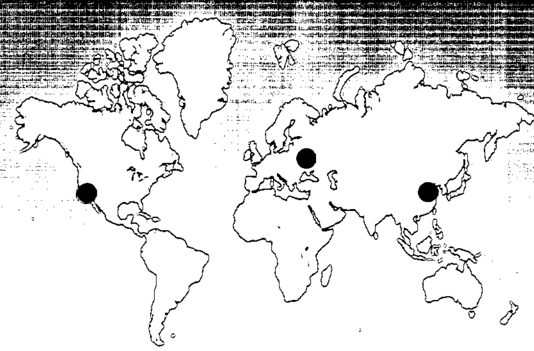
5

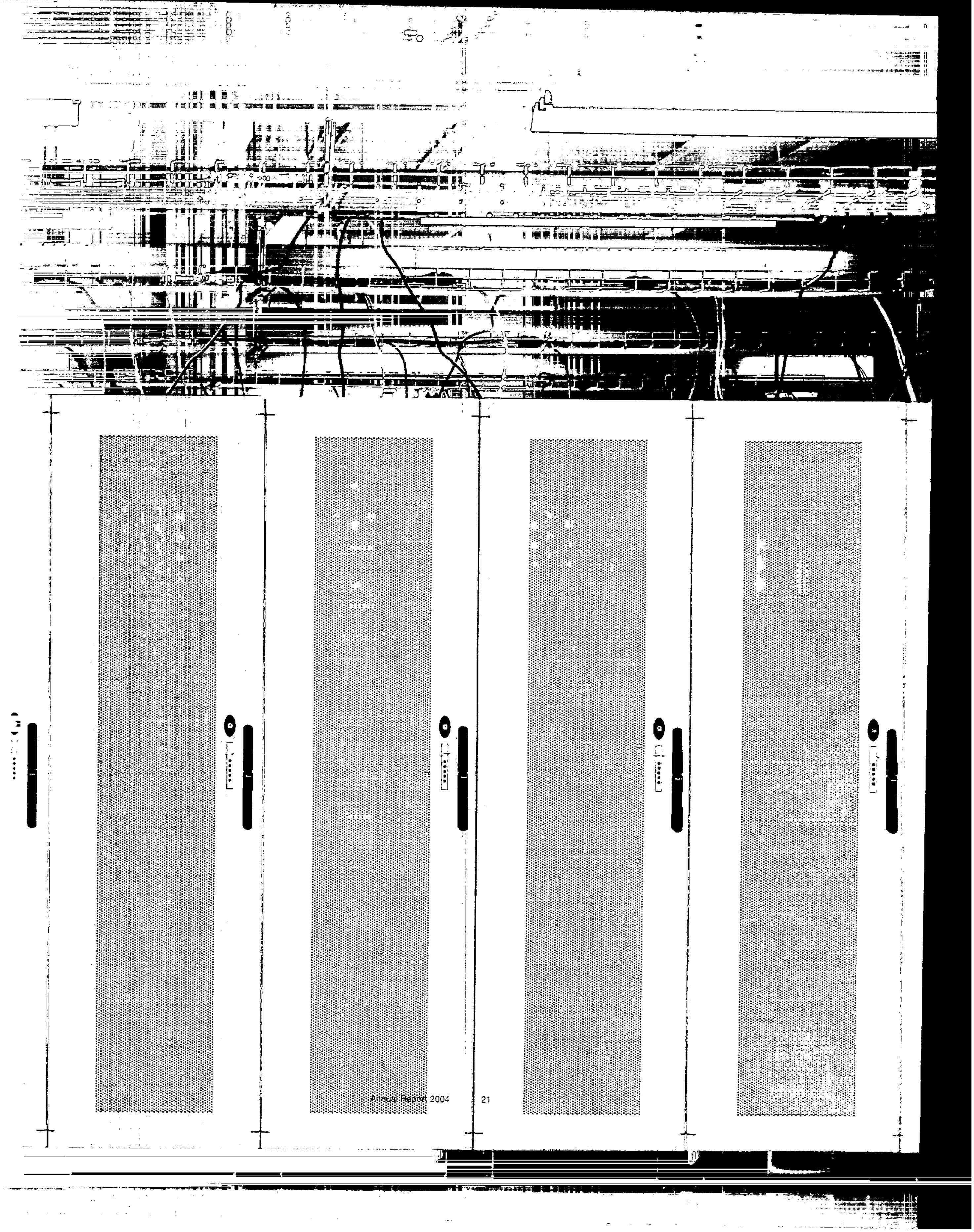
We are investing in the resources necessary to significantly expand our International revenues from the historic contribution of 15% to 20% of total revenues. Our expansion efforts include:

Europe significant investment in the management and sales staff for our European sales headquarters in the Netherlands

Asia setting up our Taiwan and Hong Kong offices

International discussing the potential for International co-branding partnerships





Financial Content

Supplementary Financial Information 26

Management's Discussion and Analysis of Financial Condition and Results of Operation 27

Report of Independent Registered Public Accounting Firm 45

Consolidated Balance Sheets 47

Consolidated Statements of Cash Flows 50

Notes to Consolidated Financial Statements 51

This Report may be deemed to contain forward-looking statements, which are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words such as "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, statements that refer to projections of our financial performance, anticipated growth and trends in our markets, future financial condition, our market leadership, and other characterizations of future events or circumstances, are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and may differ materially from actual future events or results. Readers are urged to read the documents filed by SimpleTech with the SEC, specially our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, which identify risk factors that could cause actual results to differ materially from the forward-looking statements. These risk factors include, among others: business and economic conditions and growth trends in the Flash and DRAM industries; economic conditions and uncertainties in the geopolitical environment; component supply constraints; variations in customer demand for products and services, including the timing of orders and manufacturing lead times; changes in customer order patterns or customer mix; dependence on a small number of customers; dependence on the limited number of suppliers; insufficient, excess, or obsolete inventory; variability of component costs; increased price competition; variations in sales channels, products costs, or mix of products sold; the ability to successfully acquire businesses and technologies and to successfully integrate and operate these acquired businesses and technologies; increased competition in the Flash and DRAM industries; dependence on the introduction and market acceptance of new product offerings; rapid technological and market change; manufacturing risk; product defects and returns; litigation involving intellectual property and other matters; the ability to recruit and retain key personnel; financial risk management; international expansion and risks associated with operating in foreign countries; and potential volatility in operating results. The financial information contained in this Report should be read in conjunction with the Consolidated Financial Statements and notes thereto included in this Report. We are under no duty to update any forward-looking statements to conform these statements to actual results or to reflect the occurrence of unanticipated events, unless required by law.

This Report includes statistical data regarding our company and the industries in which we compete. These data are based on our records taken or derived from information published or prepared by various sources, including SIA and Coughlin Associates and Web-Feet Research. Market data used throughout this Report are based upon industry sources and the good faith estimates of our management, based upon relevant information known to them. Although we believe those sources are reliable, the accuracy and completeness of this information is not guaranteed and has not been independently verified. The information on our website is not deemed a part of this Report.

Business Overview

SimpleTech designs, manufactures and markets custom and open-standard memory solutions based on Flash memory and dynamic random access memory, or DRAM, technologies as well as external hard drive storage solutions. We offer a comprehensive line of more than 2,500 products and specialize in developing high-density memory modules, memory cards and storage drives. One way that we distinguish ourselves in the marketplace is by offering 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.

The growth in demand for consumer electronic devices such as digital cameras, MP3 digital audio players, personal digital assistants, or PDAs, digital camcorders and smart phones, as well as the increased memory requirements of these devices, has helped fuel the increased use of non-volatile data storage Flash memory, or NAND Flash. NAND Flash is the preferred technology for these applications because it is lightweight, durable, rugged, compact and retains data without power. Our Flash cards store digital content such as pictures, digital music, video clips and files in a small form factor with large storage capacity and low power consumption. We offer our Flash cards in all major media formats, including CompactFlash, Secure Digital and MultiMedia cards. In addition to the demand in consumer markets, our Flash business is also expanding 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. According to Web-Feet Research in a report dated March 2005, NAND Flash industry revenues are expected to grow from $7.4 billion in 2004 to $16.6 billion in 2007.

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. We have recently experienced growing demand for our IC Tower stacking products driven by our increased penetration of the server market. We believe this technology allows our customers to design memory-intensive systems on a differentiated and more price competitive basis. We also believe the growth of the DRAM market will be driven primarily by the next PC upgrade cycle, the demand for increased memory content per PC and a resumption of IT spending. According to SIA in a report dated November 2004, the DRAM industry is expected to grow from $26.9 billion in 2004 to $30.1 billion in 2007.

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. According to Coughlin Associates, the 3.5 inch and portable external storage industry is expected to grow from $1.4 billion in 2004 to $3.2 billion in 2007.

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. In 2004, our Consumer Division sold to more than 1,000 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. 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. In 2004, 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. 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.

Sales of Flash memory and DRAM products accounted for substantially all of our total revenues in 2004 and 2003. The balance is composed of sales of storage products. We have no long-term sales contracts with our customers. Our ten largest customers accounted for an aggregate of 68.4% and 51.9% of our total revenues in 2004 and 2003, respectively. Micron Semiconductor, CDW Computer Centers and Smart Modular accounted for 21.3%, 17.9% and 13.7% of our total revenues in 2004 and CDW Computer Centers accounted for an aggregate of 19.2% of our total revenues in 2003. As of December 31, 2004 and 2003, approximately 38.4% and 21.3% of accounts receivable were concentrated with three and two customers, respectively. No other single customer accounted for more than 10.0% of our total revenues or accounts receivable in 2004 or 2003.

International sales of our products accounted for $50.3 million, or 18.2%, and $39.8 million, or 18.8%, of our total revenues in 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. Substantially all of our international sales are export sales, which are shipped from our domestic facility to foreign customers. For additional information about our business, including our OEM and Consumer Divisions and international sales, please see the notes to our consolidated financial statements included elsewhere in this Report.

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, 2004 and the consolidated balance sheet data at December 31, 2003 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, 2000 and 2001 and the consolidated balance sheet data at December 31, 2000, 2001 and 2002 were derived from our audited consolidated financial statements and are not included in this Report.

Year Ended December 31, (in thousands)	2004	2003	2002	2001	2000
Consolidated Statement of Operations Data:					
Net revenues	$ 275,432	$ 211,806	$ 176,531	$ 164,241	$ 308,316
Cost of revenues	228,269	175,927	143,582	127,832	239,964
Gross profit	47,163	35,879	32,949	36,409	68,352
Sales and marketing	19,875	18,787	17,527	18,078	21,588
General and administrative	10,106	10,077	10,328	11,262	11,853
Research and development	4,295	2,445	2,762	4,297	3,745
Non-recurring legal settlement					1,810
Total operating expenses	34,276	31,309	30,617	33,637	38,996
Operating income (loss)	12,887	4,570	2,332	2,772	29,356
Interest income (expense), net	1,052	557	778	1,395	(1,158)
Income (loss) from continuing operations before provision (benefit) for income taxes	13,939	5,127	3,110	4,167	28,198
Provision (benefit) for income taxes	5,158	1,645	(188)	1,655	2,838
Income (loss) from continuing operations	$ 8,781	$ 3,482	$ 3,298	$ 2,512	$ 25,360
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)	$ 4,689	$ (1,648)	$ (1,391)		
Pro Forma Data[1]:					
Income before provision for income taxes					$ 28,198
Pro forma provision for income taxes					10,883
Pro forma net income					$ 17,315
Net income (loss) per share (pro forma in 2000)[2]:					
Basic:					
Continuing operations	$ 0.18	$ 0.09	$ 0.08	$ 0.07	$ 0.53
Discontinued operations	$ (0.08)	$ (0.13)	$ (0.12)	–	–
Total	$ 0.10	$ (0.04)	$ (0.04)	$ 0.07	$ 0.53
Diluted:					
Continuing operations	$ 0.17	$ 0.08	$ 0.08	$ 0.06	$ 0.50
Discontinued operations	$ (0.08)	$ (0.12)	$ (0.11)	$ –	$ –
Total	$ 0.09	$ (0.04)	$ (0.03)	$ 0.06	$ 0.50
Shares used in computation of net income (loss) per share:					
Basic	47,707,365	40,408,610	38,515,825	38,126,687	32,393,218
Diluted	49,563,208	42,559,586	40,336,008	39,435,505	34,593,678

December 31, (in thousands)	2004	2003	2002	2001	2000
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 73,346	$ 30,769	$ 24,442	$ 51,831	$ 33,747
Marketable securities	9,972	45,625	19,530	–	–
Working capital	121,564	114,112	60,681	64,733	64,300
Total assets	153,409	153,669	94,240	89,114	103,286
Long-term portion of debt and capital lease obligations	–	–	–	384	1,642
Total shareholders' equity	131,428	128,324	73,902	74,045	69,913

(1) From our formation in March 1990 to September 26, 2000, we elected for federal and state income tax purposes to be treated as an S corporation under Subchapter S of the Internal Revenue Code of 1986 and comparable state tax laws and filed our federal and state income tax returns on that basis. Accordingly, no provision has been made for federal or certain state income taxes. Pro forma net (loss) income has been computed using an effective tax rate of 38% to reflect the estimated income tax (benefit) expense as if we had been fully subject to federal and state income taxes as a C corporation for all periods presented. Subsequent to the termination of our S corporation status on September 26, 2000, we have paid federal and state corporate-level income taxes as a C corporation.

(2) Reflects a 5.07 for 1 stock split of our common stock in September 2000. All share and per share amounts have been adjusted to give retroactive effect to the stock split.

SUPPLEMENTARY FINANCIAL INFORMATION

Supplementary Financial Information is included in Note 13 to our consolidated financial statements included elsewhere in this Report.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

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 45. 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 "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. was originally incorporated in California in March 1990 as Simple Technology, Inc. Our name was then changed to SimpleTech, Inc. in May 2001. SimpleTech designs, manufactures and markets custom and open-standard memory solutions based on Flash and DRAM memory technologies. Headquartered in Santa Ana, California, SimpleTech offers a comprehensive line of over 2,500 products and specializes in developing high-density memory modules, memory cards and storage drives.

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. We expect that several of the initiatives we implemented in 2004, such as discontinuing the operations of our Xiran Division and reducing our general and administrative costs, including legal and litigation costs, will result in a decrease in operating expenses of nearly $10 million per year. Our consolidated financial statements have been reclassified to reflect the Xiran Division as a discontinued operation for all prior periods presented.

After we experienced revenue growth of 57.5% from 1998 to 1999 and 60.1% from 1999 to 2000, revenues declined 46.7% in 2001 and then increased 7.5% in 2002, 20.0% in 2003 and 30.0% in 2004. Annual revenues in 2001 and 2002 were negatively impacted by deteriorating macroeconomic conditions, severe declines in the price of DRAM components, and significantly reduced sales to customers in the communications and networking markets. These negative conditions began to improve in the second quarter of 2003 and have continued to improve through the end of 2004 as demand for DRAM products increased and component prices stabilized. However, there can be no assurance that Flash and DRAM demand or component prices will increase or remain stable or that such trends will continue in the future. We have targeted five areas for potential revenue growth in 2005: Flash-based products for military applications, reduced-sized Flash cards for mobile handsets, expansion of our international business, stacking products for new server and telecom customers and external NAS storage devices in retail stores and for OEMs.

Over the past several years, we have experienced an increase in demand for our Flash products as a result of the growth in consumer electronics and OEM applications, such as the replacement of rotating disk drives with Flash products. Our Flash revenues increased from $24.9 million for the year ended December 31, 1999 to $54.7 million for the year ended December 31, 2002 to $80.3 million for the year ended December 31, 2003. Despite this growth, our revenues from Flash products in 2004 dropped to $62.2 million due to the negative impact of Flash supply constraints and competitive component pricing issues. We believe the expected addition of new Flash suppliers in the industry and increased industry Flash capacity in 2005, as well as the launch in late 2004 of our new Flash products targeted at military and mobile handset applications, will have a positive impact on our Flash revenues and gross margins as well as our competitiveness in the market. We had no revenue from these new Flash products in 2004.

In addition, we have experienced significant growth over the past year in demand for our IC Tower stacking DRAM products from customers in the networking and server market sectors. Our high-capacity IC Tower stacking DRAM modules are used by our customers in their high-end switching equipment and enterprise servers where maximizing memory content in the device is a priority. Our IC Tower stacking DRAM revenues have grown from $34.2 million for the year ended December 31, 2003 to $104.9 million for the year ended December 31, 2004.

We sell our products through our Consumer Division and OEM Division. Our Consumer Division sells our products through the following channels: VAR, mail order, distributor and mass market retailer. Our OEM Division was created in late 1998 to enhance the marketing of our products to OEMs.

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 revenues. Our ten largest customers accounted for an aggregate of 68.4% of our total revenues in 2004, 51.9% of our total revenues in 2003 and 55.5% of our total revenues in 2002. Micron Semiconductor, CDW Computer Centers and Smart Modular accounted for 21.3%, 17.9% and 13.7%, respectively, of our total revenues in 2004. CDW Computer Centers accounted for 19.2% of our total revenues in 2003 and 21.1% of our total revenues in 2002. Other than Micron Semiconductor, CDW Computer Centers and Smart Modular, no other customer accounted for more than 10.0% of our total revenues in 2004, 2003 and 2002. 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 constituted 18.2% of our total revenues in 2004, 18.8% of our total revenues in 2003 and 14.8% of our total revenues in 2002. Except for Europe, which accounted for 10.3% of our revenues in 2003, no other foreign geographical area or single foreign country accounted for more than 10.0% of our revenues in 2004, 2003 and 2002. Over 95.0% of our international sales were denominated in U.S. dollars in 2004, 2003 and 2002. In addition, our purchases of IC 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."

In the past, we have been 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.

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.

	2004	2003	2002
Net revenues	100.0%	100.0%	100.0%
Cost of revenues	82.9	83.1	81.3
Gross profit	17.1	16.9	18.7
Operating expenses			
Sales and marketing	7.2	8.9	9.9
General and administrative	3.7	4.8	5.9
Research and development	1.5	1.1	1.6
Total operating expenses	12.4	14.8	17.4
Operating income	4.7	2.1	1.3
Interest income	0.4	0.3	0.4
Income before provision for income taxes	5.1	2.4	1.7

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 revenue was due to a 113% increase in average sale price from $67 in 2003 to $143 in 2004, and a 6% increase in OEM Division unit volume. Our OEM Division revenue 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 revenue was due to a 18% decrease in unit volume, partially offset by a 14% increase in average sale 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 2004 and 2003. General and administrative expenses as a percentage of revenues decreased from 4.8% in 2003 to 3.7% in 2004 primarily due to leveraging certain fixed general and administrative costs against a larger revenue base.

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. These product lines, which were launched in late 2004, are expected to contribute to revenue in the first half of 2005.

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.

COMPARISON OF THE YEARS ENDED DECEMBER 31, 2003 AND 2002

Net Revenues. Our revenues were $211.8 million in 2003, compared to $176.5 million in 2002. Revenues increased 20.0% in 2003 due primarily to a 12% increase in units shipped and a 6% increase in average sales price from $50 in 2002 to $53 in 2003. The increase in our average sales price resulted primarily from an increase in the percentage of revenues derived from our OEM Division, which typically sells higher-capacity products with a higher average sales price. Unit shipments growth was comprised of unit volume increases of 149% for IC Tower stacking products and 36% for Flash products, partially offset by decreases of 48% for non-DRAM, non-Flash products and 6% for non-stacked DRAM memory products.

Our OEM Division revenues increased 41.0% from $41.5 million in 2002 to $58.4 million in 2003. The increase was due primarily to a 31% increase in OEM Division average sales price from $51 in 2002 to $67 in 2003, and a 7% increase in OEM Division unit volume. The increase in OEM Division average sales price resulted primarily from an increase in the percentage of OEM Division revenues derived from our IC Tower stacking products, which are typically higher-capacity products with a higher average sales price. Our Consumer Division revenues increased 13.6% from $135.0 million in 2002 to $153.4 million in 2003. Consumer Division revenues increased in 2003 due primarily to a 14% increase in Consumer Division unit volume. Consumer Division average sales price was flat at $49 in 2003 and 2002.

Our combined backlog was $12.5 million as of December 31, 2003, compared to $5.8 million as of December 31, 2002. Our OEM Division backlog was $7.5 million as of December 31, 2003, compared to $4.3 million as of December 31, 2002. Our Consumer Division backlog increased from $1.5 million as of December 31, 2002, to $5.0 million as of December 31, 2003, as a result of increased Consumer Division orders booked in the fourth quarter of 2003 compared to the fourth quarter of 2002. 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 was $35.9 million in 2003, compared to $32.9 million in 2002. Gross profit as a percentage of revenues was 16.9% in 2003, compared to 18.7% in 2002. Gross profit as a percentage of revenues decreased due primarily to reduced OEM Division gross profit as a percentage of revenues. Gross profit for our OEM Division as a percentage of OEM Division revenues was 22.0% in 2003, compared to 30.1% in 2002. This decrease in gross profit as a percentage of revenues for our OEM Division resulted primarily from a negative shift in product mix. Gross profit for our Consumer Division as a percentage of Consumer Division revenues was 14.9% in 2003, compared to 15.1% in 2002.

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 were $18.8 million in 2003, compared to $17.5 million in 2002. Sales and marketing expenses as a percentage of revenues were 8.9% in 2003, compared to 9.9% in 2002. Sales and marketing expenses increased due primarily to increased revenues and expanded Consumer Division marketing programs in 2003. 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 2003, compared to $10.3 million in 2002. General and administrative expenses as a percentage of revenues were 4.8% in 2003 and 5.9% in 2002. General and administrative expenses were relatively flat in comparing 2003 and 2002.

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 were $2.4 million in 2003, compared to $2.8 million in 2002. Research and development expenses as a percentage of revenues were 1.1% in 2003, compared to 1.6% in 2002. Research and development expenses were relatively flat in comparing 2003 and 2002.

Interest Income, Net. Interest income, net is comprised primarily of interest income from our cash, cash equivalents and marketable securities and interest expense related to our equipment financing. Interest income, net was $557,000 in 2003, compared to $778,000 in 2002. This decrease in interest income resulted primarily from lower interest rates in 2003, compared to 2002. Interest expense is comprised of interest related to equipment financing. There was no interest expense in 2003. Interest expense was $77,000 in 2002.

Provision for Income Taxes. Provision for income taxes was $1.6 million in 2003, compared to a benefit of $188,000 in 2002. As a percentage of income from continuing operations before provision (benefit) for income taxes, provision for income taxes was 32.0% in 2003 and benefit for income taxes was (6.0%) in 2002. The Company recorded a benefit for income taxes in 2002 primarily due to a non-recurring research and development income tax benefit of approximately $927,000.

Income from Continuing Operations. Income from continuing operations was $3.5 million and $3.3 million in 2003 and 2002, respectively.

Discontinued Operations. In June 2004, we discontinued the operation of our Xiran Division. The operating expense figures above do not include operating expenses related to our discontinued Xiran Division during 2003 and 2002.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2004, we had working capital of $121.6 million, including $73.3 million of cash and cash equivalents and $10.0 million in marketable securities, 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 6.5 times current liabilities at the end of 2004, compared to 5.5 times current liabilities at the end of 2003.

Net cash provided by operating activities was $10.1 million in 2004 and resulted 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

Net cash provided by investing activities was $34.4 million in 2004, compared to net cash used in investing activities of $28.2 million in 2003. In 2004, net cash provided by investing activities resulted 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. In 2003, net cash used in investing activities was attributable primarily to $26.1 million of investments in marketable securities. Although we had no material capital expense commitments as of December 31, 2004, we expect to spend up to approximately $2.5 million to $4.5 million during the next 24 months, primarily for manufacturing, testing and engineering equipment.

Net cash used in financing activities was $1.9 million in 2004 and resulted primarily from the $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 repurchase of up to $15 million of our outstanding common stock from time to time over the next 18 months. We repurchased 841,509 shares of common stock at an average share price of $3.68, including commissions, in 2004. Shares may be purchased from time to time at prevailing market prices through open market or unsolicited negotiated transactions, depending on market conditions and other considerations. There is no guarantee as to the exact number of shares that will be repurchased by us, and we may discontinue purchases at any time when management determines that additional purchases are not warranted. Repurchased shares would be returned to the status of authorized but unissued shares of common stock. We believe that all funds required for the repurchase of common stock will be obtained from our available cash resources and marketable securities.

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;
* price discounts on our products to our customers;
* our pursuit of strategic transactions;
* 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;
* capital improvements to new and existing facilities;
* technological advances; and
* competitors responses to our products.

CONTRACTUAL OBLIGATIONS

The following summarizes our contractual obligations at December 31, 2004. We do not have off-balance sheet financing arrangements as of December 31, 2004.

	Payment due by period				
Contractual Obligation	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating Lease Obligations	$7,901,000	$ 919,000	$1,206,000	$1,206,000	$4,570,000

INFLATION

Inflation was not a material factor in either revenue or operating expenses during the past three fiscal years ended December 31, 2004, 2003 and 2002.

NEW ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 151, Inventory Costs: an amendment of ARB No. 43, Chapter 4, Inventory Pricing. This standard clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and waste material (spoilage). Such abnormal expenses must be recognized in the period in which they are incurred. In addition, SFAS No. 151 requires the allocation of fixed production overhead to inventory based on the normal capacity of the production facilities. Unallocated overheads must be recognized as an expense in the period in which they are incurred. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not expect the adoption of this statement to have a material impact on our results of operations, financial position or cash flows.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, that amends Opinion 29 to eliminate the exception from fair value measurement for nonmonetary exchanges of similar productive assets and replaces it with an exception for exchanges that do not have commercial substance. The provisions of this Statement are effective for all nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. We do not expect the adoption of the Statement to have a material effect on our results of operations, financial position or cash flows.

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment, which is a revision of SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 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. SFAS No. 123(R) is effective for all stock-based awards granted on or after July 1, 2005. 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 of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. We are currently assessing the impact that adoption of this standard will have on our consolidated financial statements; however, we believe that adoption of this standard will result in a charge to reported earnings.

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 sold through resulting finished goods to customers for a profit. 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.
* *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." Sales and marketing incentives amounted to $7.4 million for 2004 and $8.4 million for 2003, respectively, of which $5.2 million and $4.9 million, respectively, were offset against revenues, and $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.

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, 2004, our cash and cash equivalents were $73.3 million invested in money market and other interest bearing accounts.

At December 31, 2004, our investment in marketable securities was $10.0 million. The marketable securities consist of certificates of deposit with an original maturity of one year at different financial institutions. At December 31, 2004, these marketable securities had a weighted-average time to maturity of approximately 84.6 days. Marketable securities represent investments with an original maturity of greater than three months. These securities are classified as held to maturity because we have the intention and ability to hold the securities to maturity. Gross unrealized gains and losses on held-to-maturity marketable securities have historically not been material.

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 $733,000. 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, cash equivalents and marketable securities as of December 31, 2004 were as follows:

	Expected Maturity Date			Fair Value
	2005	Thereafter	Total	12/31/2004
Investments				
Cash and cash equivalents:				
Money Market Funds	$73,346,000	$ 0	$73,346,000	$73,346,000
Weighted average interest rate	2.06%		2.06%	2.06%
Total cash and cash equivalents	$73,346,000	$ 0	$73,346,000	$73,346,000
Weighted average interest rate	2.06%		2.06%	2.06%
Marketable securities	$ 9,972,000	$ 0	$ 9,972,000	$ 9,972,000
Weighted average interest rate	1.50%		1.50%	1.50%

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.

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 product and revenue mix;
* Seasonal purchasing patterns for our 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;
* 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 acquisitions;
* 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. 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 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. Renesas, Matsushita and Samsung supply substantially all of the IC devices used in our Flash memory products. In addition, Infineon Technologies, Micron Technology 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 Infineon Technologies, Micron Technology or Samsung 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 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 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. Additionally, 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.

Declines in our average sales prices may result in declines in our revenues and gross profit. Our average sales prices may decline due to several factors. During the majority of 2001 and 2002, and the first four months of 2003, overcapacity in the DRAM memory component market resulted in significant declines in component prices, which negatively impacted our average sales prices, revenues and gross profit. Declines in semiconductor prices could also affect the valuation of our inventory, which could harm our financial results. 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. Our 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.

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. From 2001 through the first quarter of 2003, a downturn in the semiconductor industry negatively impacted our average sales prices, revenues and earnings. These conditions began to improve during the second quarter of 2003 and have continued to improve through the end of 2004 as demand for DRAM products increased and component prices stabilized. However, there can be no assurance that the demand for DRAM products will increase or component prices will remain stable or that such trends will continue in the future. 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 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 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. Our largest Consumer Division customer in 2004 and 2003, CDW Computer Centers, accounted for 34.2% of our Consumer Division revenues, or 17.9% of our total revenues, for 2004 and 26.6% of our Consumer Division revenues, or 19.2% of our total revenues, in 2003. No other Consumer Division customer accounted for more than 10.0% of our total revenues in 2004 or 2003.

Our ten largest OEM Division customers accounted for an aggregate of 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. Our largest OEM Division customers in 2004, Micron Semiconductor and Smart Modular, accounted for 44.6% and 29.8%, respectively, of our OEM Division revenues, or 21.3% and 13.7%, respectively, of our total revenues, for 2004. No other single OEM Division customer accounted for more than 10.0% of our total revenues in 2004 or 2003.

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.

Our ability to use our net operating loss and tax credit carryforwards may be substantially limited, which could harm our financial condition. In recent years, we generated net operating losses and tax credits, which we have not been able to fully utilize at this time. The availability of some of these net operating losses and tax credit carryforwards are subject to expiration and/or certain limitations. As of December 31, 2004, we had federal net operating loss carryforwards of approximately $1.1 million, which begin to expire in 2023, and state net operating loss carryforwards of approximately $100,000, which begin to expire in 2013. As of December 31, 2004, we had federal research and development credit carryforwards of approximately $1.5 million, which begin to expire in 2022. In addition, we had the following state credits as of December 31, 2004: research and development credit carryforwards of approximately $1.8 million, which carryforward indefinitely; enterprise zone credit carryforwards of approximately $1.9 million, which carryforward indefinitely; and manufacturer's investment credit carryforwards of approximately $498,000, which begin to expire in 2009. We are required to periodically review our ability to use our net operating loss and tax credit carryforwards. Such review may result in the limiting of the amount of net operating losses or tax credit carryforwards that can be utilized in the future to offset future taxable income or tax liabilities. Since the 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 net operating loss and tax credit carryforwards were substantially limited, it could harm our financial condition.

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.

In addition, there has been an ongoing public debate as to whether employee stock option and employee stock purchase plan shares should be treated as a compensation expense and, if so, how to properly value such charges. We have accounted for employee stock options and employee stock purchase plan shares for financial and accounting purposes under APB Opinion No. 25, which does not count the grant of stock or options as an expense. In December 2004, the Financial Accounting Standards Board published amendments to financial accounting standards that will require that awards under such plans be treated as compensation expense using the fair value method. Although management is continuing to assess the implications of this revised standard, we believe this revised standard will likely significantly increase our compensation expense, could make our operating results less predictable and could change 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 10 – "Stock Option Plan".

Failure to maintain effective internal controls over financial reporting could adversely affect our business and the market price of our common stock. Section 404 of the Sarbanes-Oxley Act of 2002 requires that we undertake a thorough re-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 to report to our shareholders about the condition of our internal control systems, and our auditors will be requested to attest to that report. The independent public accounting firm that audits our financial statements will review our systems for weaknesses and comment on any material weaknesses. 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 and our independent public accounting firm's timely completion of the review of our internal control systems. Our independent public accounting firm is responsible for auditing and reviewing managements' reports of many other companies, and our deadlines could be difficult for them to meet. 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 irremediable weaknesses in our internal controls over financial reporting, our management will be unable to assert such internal controls are effective. If we are unable to assert that our internal controls over financial reporting are effective, or if our auditors are 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, we could lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our business and the market price of our common stock.

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. Although we are uncertain about the total costs we will incur in connection with these efforts, 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. There is great demand for consultants in this area, and their fees reflect the short supply, which was caused by thousands of companies concurrently trying to comply with Section 404 of the Sarbanes-Oxley Act of 2002. The costs to comply with evolving laws, regulations and standards may offset a portion of the savings we realized through our efforts to reduce our expenses. 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. Any potential future acquisitions also involve numerous risks, including, among others:

* Problems assimilating the purchased operations, technologies or products;
* Costs associated with the acquisition;
* Adverse effects on existing business relationships with suppliers and customers;
* Risks associated with entering markets in which we have no or limited prior experience;
* Potential loss of key employees of purchased organizations; and
* Potential litigation arising from the acquired company's operations before the acquisition.

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 a potential future acquisition increases. 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 one-time charge of approximately $3.0 million in the second quarter of 2004.

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 57.9% of our outstanding common stock at December 31, 2004. 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 in Note 9 to our consolidated financial statements and contained elsewhere in this Report. Because litigation is inherently uncertain, we cannot predict the outcome of this lawsuit. This lawsuit is expected 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. As a result, our defense of this lawsuit, regardless of its eventual outcome, will likely 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. 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.

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 Micron Semiconductor Electronics 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.

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.

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.

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 and MultiMedia cards. If we decide to manufacture Flash products utilizing emerging formats, such as the xD Picture Card, 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. 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.

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 sold 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 $1.1 million in 2004, compared to $367,000 in 2003. Inventory write-downs increased in 2004 due primarily to greater DRAM and Flash component price volatility compared to 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 $854,000 in 2004, compared to $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 $298,000 in 2004, compared to $1.4 million in 2003. 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, 2004, 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 relatively flat at $1.1 million in 2004, compared to $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. 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.

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. 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;
* *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.

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 18.2% and 18.8% of our revenues in 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 2004 or 2003. For 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.

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 facility would substantially harm our business. All of our manufacturing operations are located in our facility 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.

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.

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.

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, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, 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.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Orange County, California
March 11, 2005

Consolidated Balance Sheets

December 31, (in thousands, except share and per share amounts)	2004	2003
ASSETS:		
CURRENT ASSETS:		
Cash and cash equivalents	$ 73,346	$ 30,769
Marketable securities	9,972	45,625
Accounts receivable, net of allowance of $993 and $1,129 at December 31, 2004 and 2003, respectively	37,047	33,036
Inventory, net	19,002	26,704
Deferred income taxes	1,515	1,087
Other current assets	2,663	2,236
Total current assets	143,545	139,457
Furniture, fixtures and equipment, net	6,146	9,263
Intangibles, net	373	372
Deferred income taxes	3,345	4,577
Total assets	$ 153,409	$ 153,669
LIABILITIES AND SHAREHOLDERS' EQUITY:		
CURRENT LIABILITIES:		
Accounts payable	$ 16,553	$ 20,388
Accrued and other liabilities (Note 5)	5,428	4,957
Total liabilities	21,981	25,345
Commitments and contingencies (Note 9)		
SHAREHOLDERS' EQUITY:		
Preferred stock, $0.001 par value, 20,000,000 shares authorized, no shares issued and outstanding	–	–
Common stock, $0.001 par value, 100,000,000 shares authorized, 47,450,722 shares issued and outstanding as December 31, 2004; 47,776,257 shares issued and outstanding as December 31, 2003	47	48
Additional paid-in capital	121,193	122,777
Retained earnings	10,188	5,499
Total shareholders' equity	131,428	128,324
Total liabilities and shareholders' equity	$ 153,409	$ 153,669

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

Consolidated Statements of Operations

Year Ended December 31, (in thousands, except share and per share amounts)	2004	2003	2002
Net revenues	$ 275,432	$ 211,806	$ 176,531
Cost of revenues	228,269	175,927	143,582
Gross profit	47,163	35,879	32,949
Sales and marketing	19,875	18,787	17,527
General and administrative	10,106	10,077	10,328
Research and development	4,295	2,445	2,762
Total operating expenses	34,276	31,309	30,617
Income from operations	12,887	4,570	2,332
Interest income	1,052	557	855
Interest expense	–	–	77
Income before provision for income taxes	13,939	5,127	3,110
Provision (benefit) for income taxes	5,158	1,645	(188)
Income from continuing operations	8,781	3,482	3,298
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)	$ 4,689	$ (1,648)	$ (1,391)
Net income (loss) per share:			
Basic:			
Continuing operations	$ 0.18	$ 0.09	$ 0.08
Discontinued operations	$ (0.08)	$ (0.13)	$ (0.12)
Total	$ 0.10	$ (0.04)	$ (0.04)
Diluted:			
Continuing operations	$ 0.17	$ 0.08	$ 0.08
Discontinued operations	$ (0.08)	$ (0.12)	$ (0.11)
Total	$ 0.09	$ (0.04)	$ (0.03)
Shares used in computing net income (loss) per share:			
Basic	47,707,365	40,408,610	38,515,825
Diluted	49,563,208	42,559,586	40,336,008

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

Consolidated Statements of Shareholders' Equity

(in thousands, except share amounts)	Common Stock Shares	Common Stock Amount	Additional Paid In Capital	Unearned Stock Based Compensation	Retained Earnings	Total Shareholders' Equity
Balances, December 31, 2001	38,272,050	$ 38	$ 65,484	$ (15)	$ 8,538	$ 74,045
Net loss					(1,391)	(1,391)
Compensation related to stock options vesting			48	15		63
Issuance of common shares under employee stock	94,833		222			222
Exercise of stock options	358,917	1	549			550
Tax benefits from exercise of stock options			413			413
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

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

Consolidated Statements of Cash Flows

Year Ended December 31, (in thousands)	2004	2003	2002
Cash flows from operating activities:			
Net income (loss)	$ 4,689	$ (1,648)	$ (1,391)
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Depreciation and amortization	3,250	3,542	3,545
(Gain) loss on sale of furniture, fixtures and equipment	(27)	(50)	122
Restructuring and impairment charges	50	(141)	–
Loss on disposal of segment	2,979	–	–
Accounts receivable provisions	1,156	2,164	1,463
Inventory excess and obsolescence expense	1,142	367	304
Deferred income taxes	804	(3,258)	(1,033)
Compensation related to stock options vesting	–	–	63
Tax benefit from exercise of stock options	333	1,433	413
In-process research and development	–	–	1,560
Change in operating assets and liabilities:			
Accounts receivable	(5,177)	(16,181)	(7,880)
Inventory	4,961	(12,930)	(4,602)
Other assets	(490)	1,623	497
Accounts payable	(3,776)	4,007	6,061
Accrued and other liabilities	218	1,113	661
Net cash provided (used in) by operating activities	10,112	(19,959)	(217)
Cash flows from investing activities:			
Marketable securities	35,653	(26,095)	(19,530)
Purchase of intangible assets	(400)	–	–
Purchase of furniture, fixtures and equipment	(1,465)	(2,329)	(5,383)
Proceeds from sale of furniture, fixtures and equipment	595	186	717
Acquisition of assets	–	–	(2,295)
Net cash provided by (used in) investing activities	34,383	(28,238)	(26,491)
Cash flows from financing activities:			
Repayments of borrowings from banks	–	–	(1,012)
Payments on capital lease obligations	–	(113)	(441)
Proceeds from exercise of stock options	1,215	1,304	550
Stock buyback	(3,099)	–	–
Proceeds from issuance of common stock	(34)	53,333	222
Net cash (used in) provided by financing activities	(1,918)	54,524	(681)
Net increase (decrease) in cash	42,577	6,327	(27,389)
Cash and cash equivalents at beginning of period	30,769	24,442	51,831
Cash and cash equivalents at end of period	$ 73,346	$ 30,769	$ 24,442
Supplemental disclosure of cash flow information:			
Cash paid during the year:			
Income taxes	$ 890	$ 6	$ 10
Interest	$ –	$ –	$ 78

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

Notes to Consolidated Financial Statements

NOTE 1. COMPANY ORGANIZATION:

Simple Technology, Inc., incorporated in March 1990 and renamed SimpleTech, Inc. in May 2001, designs, manufactures and markets a comprehensive line of memory and storage products, as well as connectivity products that connect memory cards and hard drive upgrade kits to PCs. The Company's memory and storage products are based on dynamic random access memory, or DRAM, static random access memory, or SRAM, and Flash memory technologies. 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.

NOTE 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 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 a 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 allowance for doubtful accounts during the years ended December 31, 2004, 2003 and 2002 (amounts in thousands):

	Balance at beginning of year	Additions	Write-offs net of recoveries	Balance at end of year
December 31, 2004	$ 1,129	$ 1,155	$ (1,291)	$ 993
December 31, 2003	$ 782	$ 2,164	($ 1,817)	$ 1,129
December 31, 2002	$ 540	$ 1,463	($ 1,221)	$ 782

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 sold through resulting finished goods to customers for a profit. 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 and assets under capital leases 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: Product sales and related cost of sales are recognized upon the shipment of product to customers provided the Company has received a purchase order, the price is fixed or determinable, collectibility of the resulting receivable is reasonably assured, returns are reasonably estimable and there are no remaining obligations. The terms of substantially all product sales are FOB shipping point. 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 of inventory, 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, 2004, 2003 and 2002, shipping and handling costs were approximately $2,171,000, $2,300,000 and $2,244,000, respectively. Amounts billed to customers for shipping and handling are included in revenues. For the years ended December 31, 2004, 2003 and 2002, shipping and handling billed to customers was $317,000, $408,000 and $361,000, 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." For the years ended December 31, 2004, 2003 and 2002, sales and marketing incentives amounted to $7,438,000, $8,427,000 and $7,529,000, of which $5,256,000, $4,932,000 and $3,415,000, respectively, were offset against revenues, and $2,182,000, $3,495,000 and $4,114,000, respectively, were charged as an operating expense.

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 its 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, 2004, 2003, and 2002, advertising costs were approximately $1,600,000, $2,114,000 and $2,469,000, respectively.

Research and Development: Research and development costs, which primarily relate to payroll-related costs, 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: SFAS No. 123, "Accounting for Stock-Based Compensation," encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related interpretations in accounting for its employee stock options because the alternative fair value accounting provided for under SFAS No. 123 (SFAS No. 123), "Accounting for Stock-Based Compensation," and amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure," requires use of option valuation models that were not developed for use in valuing employee stock options. Under the provisions of APB 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 No. 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.

Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information for the years ended December 31, 2004, 2003 and 2002 follows:

Year Ended December 31,	2004	2003	2002
Net Income, as reported	$ 4,689,000	$ (1,648,000)	(1,391,000)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(4,302,000)	(3,444,000)	(2,241,000)
Pro forma net income (loss)	$ 387,000	$ (5,092,000)	$ (3,632,000)
Net income per share:			
Basic – as reported	$ 0.10	$ (0.04)	$ (0.04)
Basic – pro forma	$ 0.01	$ (0.13)	$ (0.09)
Diluted – as reported	$ 0.10	$ (0.04)	$ (0.03)
Diluted – pro forma	$ 0.01	$ (0.13)	$ (0.09)
Weighted average shares outstanding:			
Basic	47,707,365	40,408,610	38,515,825
Diluted	48,366,698	40,408,610	38,515,825

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:

	2004	2003	2002
Weighted-average expected life (years)	5	5	5
Annual dividend per share	none	none	none
Risk-free interest rate	2.86% to 3.96%	2.14% to 3.50%	2.67% to 4.92%
Expected volatility	63%	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 No. 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 No. 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, 2004, 2003 and 2002, potentially dilutive securities consisted solely of options and resulted in potential common shares of 1,856,000, 2,151,000, and 1,820,000, respectively.

During 2004, the Company repurchased 841,509 shares of its common stock at an average price of $3.65 per share. As of March 1, 2005, the Company has repurchased 1,556,369 shares at an average price of $3.86 per share.

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:

12 months ended 12/31	2004		2003	
	acct rec	rev	acct rec	rev
Customer A	15%	14%	10%	–
Customer B	13%	21%	–	–
Customer C	11%	18%	11%	19%
Total	39%	53%	21%	19%

No other single customer accounted for more than 10% of accounts receivable or revenues at December 31, 2004 and 2003, or for each of the three years in the period ended December 31, 2004. 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, 2004 and 2003, 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 a facility 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.

In-Process Research and Development: In connection with the acquisition of substantially all the assets of Irvine Networks, LLC in January 2002 (which resulted in the creation of the Company's Xiran Division), the Company determined the amount allocated to in-process research and development utilizing the discounted cash flow appraisal method. The value of the technology acquired was the sum of the present value of projected debt-free net income, in excess of returns on requisite assets over the life of the technology. At the time of the valuation, significant assumptions forming the basis of the appraisal were that material cash inflows will commence in 2004; estimated costs to complete the product will be $8.5 million; and a discount rate of 60% which considered the stage of development of the Xiran's technology, and the nature of projections. The operations of the Xiran Division were discontinued by the Company in June 2004.

Comprehensive Income: SFAS No. 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 stockholders' 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, 2004 and 2003.

New Accounting Pronouncements: In November 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 151, Inventory Costs: an amendment of ARB No. 43, Chapter 4, Inventory Pricing. This standard clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and waste material (spoilage). Such abnormal expenses must be recognized in the period in which they are incurred. In addition, SFAS No. 151 requires the allocation of fixed production overhead to inventory based on the normal capacity of the production facilities. Unallocated overheads must be recognized as an expense in the period in which they are incurred. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect the adoption of this statement to have a material impact on its results of operations, financial position or cash flows.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, that amends Opinion 29 to eliminate the exception from fair value measurement for nonmonetary exchanges of similar productive assets and replaces it with an exception for exchanges that do not have commercial substance. The provisions of this Statement are effective for all nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not expect the adoption of the Statement to have a material effect on its results of operations, financial position or cash flows.

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment, which is a revision of SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 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. SFAS No. 123(R) is effective for all stock-based awards granted on or after July 1, 2005. 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 of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. The Company is currently assessing the impact that adoption of this standard will have on its consolidated financial statements; however, the Company believes that adoption of this standard will result in a charge to reported earnings.

NOTE 3. INVENTORY:

Inventory consists of the following:

December 31,	2004	2003
Raw materials	$ 12,316,000	$ 13,587,000
Work-in-progress	1,541,000	1,477,000
Finished goods	6,485,000	12,683,000
	20,342,000	27,747,000
Valuation allowances	(1,340,000)	(1,043,000)
	$ 19,002,000	$ 26,704,000

NOTE 4. FURNITURE, FIXTURES AND EQUIPMENT:

Furniture, fixtures and equipment consist of the following:

December 31,	2004	2003
Furniture and fixtures	$ 314,000	$ 370,000
Equipment	24,561,000	26,272,000
	24,875,000	26,642,000
Accumulated depreciation and amortization	(18,729,000)	(17,379,000)
	$ 6,146,000	$ 9,263,000

For the years ended December 31, 2004, 2003 and 2002, the Company recorded depreciation and amortization expense of approximately $3,250,000, $3,542,000 and $3,545,000, respectively.

NOTE 5. ACCRUED LIABILITIES

Accrued Liabilities consisted of the following as of:

December 31,	2004	2003
Payroll costs	$2,837,000	$3,062,000
Marketing Program Costs	$1,079,000	$1,586,000
Other	$1,512,000	$ 309,000
Total	$5,428,000	$4,957,000

NOTE 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. In connection with the acquisition, approximately $1.6 million of the purchase price was allocated to in-process research and development ("IPR&D") utilizing the discounted cash flow appraisal method. The value of the technology acquired was the sum of the present value of projected debt-free net income, in excess of returns on requisite assets over the life of the technology. At the time of the valuation, significant assumptions forming the basis of the appraisal were that material cash inflows would commence in 2004; estimated costs to complete the product would be $8.5 million; and a discount rate of 60% would be used, which considered the stage of development of Xiran's technology, and the nature of projections. The amount attributed to IPR&D 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.

In June 2004, we discontinued the operation of our 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, we 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 us, and approximately $51,000 in other charges. Monthly rent on the Xiran Division office lease, which expires on June 30, 2005, is 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.

NOTE 7. INTANGIBLE ASSETS:

Intangibles consisted of the following:

	As of December 31, 2004		As of December 31, 2003	
Amortized Intangible Assets	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Assembled Workforce	$ 0	$ 0	$ 620,000	$ (248,000)
Patent	$ 400,000	$ (26,667)	$ 0	$ 0
Total	$ 400,000	$ (26,667)	$ 620,000	$ (248,000)

Aggregate Amortization Expense:	
For the year ended 12/31/04	$ 88,666
For the year ended 12/31/03	$ 124,000
For the year ended 12/31/02	$ 124,000
Estimated Amortization Expense:	
For the year ended 12/31/05	$ 80,000
For the year ended 12/31/06	$ 80,000
For the year ended 12/31/07	$ 80,000
For the year ended 12/31/08	$ 80,000
For the year ended 12/31/09	$ 53,333

In 2004, the Company wrote off the remaining assembled workforce balance in conjunction with the discontinuation of the Xiran Division discussed further in Note 6.

NOTE 8. INCOME TAXES:

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

December 31,	2004	2003	2002
Current			
Federal	$ 311,000	$ 1,187,000	$ (2,851,000)
State	919,000	242,000	189,000
Foreign	101,000	(124,000)	–
	1,331,000	1,305,000	(2,662,000)
Deferred			
Federal	1,755,000	(2,563,000)	1,058,000
State	(951,000)	(695,000)	(2,091,000)
	804,000	(3,258,000)	(1,033,000)
Total provision (benefit) for income taxes	$ 2,135,000	$ (1,953,000)	$ (3,695,000)

For 2004 and 2003, the difference between the effective rate and the expected U.S. federal tax rate is due primarily to state taxes and an increase in deferred tax assets as a result of current year research and development tax credits recorded. For 2002, the difference between the effective rate and the expected U.S. federal tax rate is due to an increase in deferred tax assets as a result of prior year and current year federal and state research and development and other tax credits recorded in 2002.

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

December 31,	2004	2003	2002
Statutory regular federal income tax	35.0%	35.0%	35.0%
State taxes, including state tax credits net of federal benefit	3.1	2.5	(26.4)
Federal tax credits	(2.1)	(1.9)	(15.8)
Other	1.0	(3.6)	1.2
	37.0%	32.0%	(6.0)%

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

December 31,	2004	2003	2002
Provision (benefit) for income taxes from continuing operations:			
Current	$ 4,036,000	$ 1,309,000	$ 3,000
Deferred	1,122,000	336,000	(191,000)
Total provision (benefit) for income taxes from continuing operations	5,158,000	1,645,000	(188,000)
Benefit for income taxes from discontinued operations:			
Current	(2,705,000)	–	(2,868,000)
Deferred	(318,000)	(3,598,000)	(639,000)
Total benefit for income taxes from discontinued operations	(3,023,000)	(3,598,000)	(3,507,000)
Total income tax expense (benefit)	$ 2,135,000	$ (1,953,000)	$ (3,695,000)

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

December 31,	2004	2003
Current deferred tax assets (liabilities):		
Accounts receivable and inventory reserves	$1,179,000	$ 741,000
Accrued expenses	300,000	265,000
Other	36,000	81,000
Total current	1,515,000	1,087,000
Noncurrent deferred tax assets (liabilities):		
Depreciation and amortization	(870,000)	(234,000)
Operating loss carryforwards	1,787,000	4,240,000
Credit carryforwards	5,105,000	3,018,000
Capital loss carryforwards	103,000	–
State taxes	(1,416,000)	(1,125,000)
Other	14,000	13,000
	4,723,000	5,912,000
Valuation allowance	(1,378,000)	(1,335,000)
Total noncurrent	3,345,000	4,577,000
	$4,860,000	$5,664,000

At December 31, 2004, the Company had federal and state net operating loss carryforwards of approximately $1.1 million and $100,000, respectively, which begin to expire in 2023 and 2013, respectively.

At December 31, 2004, the Company has federal research and development credit carryforwards of approximately $1.5 million, which begin to expire in 2022. In addition, at December 31, 2004 the Company had the following state credits: research and development credit carryforwards of approximately $1.8 million, which carryforward indefinitely; enterprise zone credit carryforwards of approximately $1.9 million, which carryforward indefinitely; and manufacturer's investment credit carryforwards of approximately $498,000, which begin to expire in 2009.

The Company's foreign subsidiary, SimpleTech Europe, is treated as a branch partnership for income tax purposes and, therefore, is subject to U.S. taxation. At December 31, 2004 and 2003, this entity had U.K. net operating loss carryforwards of $4.5 million and $4.4 million, respectively. The losses carry over 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 $43,000 for 2004. The Company has not provided for U.S. taxes or foreign withholding taxes on approximately $32,000 of undistributed earnings from SimpleTech Europe BV 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.

NOTE 9. COMMITMENTS AND CONTINGENCIES:

DPAC Technologies, Inc. – Patent Infringement. On September 23, 1998, the Company filed a lawsuit against DPAC Technologies, Inc., formerly Dense-Pac Microsystems, Inc. ("DPAC"), in the United States District Court for the Central District of California for infringement of the Company's IC Tower stacking patent, U.S. Patent No. 5,514,907. On March 29, 2001, the District Court entered final judgment finding DPAC did not infringe the Company's patent and that the Company did not infringe DPAC's patent. The Appeals Court affirmed the final judgment on March 7, 2002. On June 3, 2002, the Company filed a petition for certiori with the U.S. Supreme Court. On October 7, 2002, the petition to the Supreme Court was granted and the matter was remanded to the Circuit Court of Appeals. DPAC filed a motion for summary affirmance with the Circuit Court of Appeals. The Court of Appeals denied the motion and remanded the matter back to District Court to reconsider the case in light of a recent decision by the U.S. Supreme Court. On September 15, 2003, the District Court re-entered judgment that DPAC does not infringe the Company's patent. Subsequently, the Company filed the appropriate documents to seek review of the last decision.

On March 8, 2004, the Company entered into a confidential settlement agreement whereby it agreed to dismiss with prejudice its appeal of the case. Under the settlement, the Company granted DPAC a paid-up, non-exclusive license under the affected patents. This settlement is a complete and amicable resolution and should not be construed as an admission by any of the parties to this litigation of any wrongdoing.

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 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. Because of the preliminary stage of this case, an estimate of potential damages, if any, would be premature and speculative. The Company has not made any such estimate at this time since it is not probable there will be an unfavorable outcome.

Staktek Corporation – Patent Infringement. On July 30, 2003, the Company filed a lawsuit against Staktek Corporation in the United States District Court for the Central District of California for infringement of its IC Tower stacking patent, U.S. Patent No. Re. 36,916. The Company sought monetary damages in an amount to be stated later, an injunction against further infringement of its patent, attorneys' fees and trebled damages. Staktek answered the complaint denying infringement and alleging that the patent is invalid.

On October 10, 2003, Staktek Group, L.P., a subsidiary of Staktek Corporation, filed a lawsuit against the Company in the United States District Court for the Western District of Texas which alleged that the Company's IC Tower stacking products infringe on Staktek's U.S. patents Nos. 6,025,642 and 6,049,123. Staktek sought a permanent injunction against further infringement of the '642 and '123 patents, monetary damages in an amount to be stated later, interest on damages, costs and attorneys' fees and trebled damages.

On March 31, 2004, the Company resolved its two lawsuits with Staktek Group L.P. The parties agreed to a mutual dismissal with prejudice of the intellectual property infringement lawsuits. In settlement of these matters, both parties agreed not to sue each other, its customers, or licensees in the future for patent infringement in connection with making or selling the products related to the lawsuits. Under the terms of the settlement, no money was exchanged, and neither party licensed its technology to the other.

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 3, the Company leases 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 12,000 square foot office space for research and development and various small facilities for sales offices and 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)
2005	$ 603,000	$ 316,000
2006	603,000	
2007	603,000	
2008	603,000	
2009	603,000	
Thereafter	4,570,000	
Net minimum lease payments	$7,585,000	$ 316,000

Rent expense for the years ended December 31, 2004, 2003 and 2002 was approximately $1,113,000, $1,009,000, and $1,030,000, respectively, inclusive of related party balances.

Repurchase Agreements. The Company is contingently liable at December 31, 2004, to various financial institutions on 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, 2004, 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 $1,100,000, $1,200,000 and $876,000 for the years ended December 31, 2004, 2003 and 2002, 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 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, 2004, 2003 and 2002, the Company made matching contributions of approximately $589,000, $506,000 and 492,000, respectively.

Company Stock Buy Back. In September 2001, the Company's Board of Directors authorized a stock repurchase program under which the Company could repurchase up to 1,800,000 shares of the Company's common stock over an 18-month period. The shares were permitted to be purchased from time to time, at prevailing market prices, through open market or unsolicited negotiated transactions, depending on market conditions and other considerations, until March 31, 2003. During 2001, the Company repurchased 72,500 shares of its common stock for a total of $92,000 under this program. During 2002 and the first quarter of 2003, the Company did not repurchase any shares of its common stock under this program. Shares of common stock repurchased have been returned to the status of authorized but unissued shares of common stock and may be issued by the Company in the future.

In June 2004, the Company's board of directors authorized the repurchase of up to $15 million of its outstanding common stock from time to time over the next 18 months. The Company repurchased 841,509 shares of common stock at an average share price of $3.68, including commissions, in 2004. Shares may be purchased from time to time at prevailing market prices through open market or unsolicited negotiated transactions, depending on market conditions and other considerations. There is no guarantee as to the exact number of shares that will be repurchased by the Company, and the Company may discontinue purchases at any time when its management determines that additional purchases are not warranted. Repurchased shares would be returned to the status of authorized but unissued shares of common stock. The Company believes that all funds required for the repurchase of common stock will be obtained from its available cash resources and marketable securities.

NOTE 10. STOCK OPTION PLAN:

The 2000 Stock Incentive Plan (the "Plan") is intended to serve as the successor equity incentive program to the 1996 Stock Option Plan (the "Predecessor Plan"). The Plan was adopted by the Company's board of directors and approved by its shareholders in June 2000. In September 2000, the Plan became effective, and all outstanding options under the Predecessor Plan were transferred into the Plan. No further option grants will be made under the Predecessor Plan. The transferred options will continue to be governed by their existing terms, unless the compensation committee of the Board of Directors elects to extend one or more features of the Plan to those options.

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 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.

On October 29, 2001, the compensation committee of the Board of Directors authorized the Company to implement an option exchange program pursuant to which the Company's then-current employees, including executive officers, were given the opportunity to exchange their outstanding options to purchase shares of the Company's common stock for new stock options for the same number of shares to be granted to them at a later date. At the conclusion of the option exchange program on December 20, 2001, the Company accepted for exchange and canceled options to purchase an aggregate of 2,309,500 shares of the Company's common stock. On June 24, 2002, the Company issued replacement options to purchase an aggregate of 2,202,500 shares of the Company's common stock at an exercise price of $5.75, which was the closing price per share of the Company's common stock on the grant date. Options to purchase an aggregate of 107,000 shares of the Company's common stock were exchanged and canceled, but not replaced, as a result of terminations of employees between the exchange date and the replacement grant date.

At December 31, 2004, the Plan provided for the issuance of up to 13,526,875 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 12/31/01	3,745,114	$ 2.78
Granted	4,678,900	$ 5.29
Exercised	(358,917)	$ 1.53
Canceled/forfeited	(1,311,445)	$ 5.34
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
Exercisable at 12/31/02	1,980,862	$ 1.93
Exercisable at 12/31/03	2,325,689	$ 3.60
Exercisable at 12/31/04	3,267,903	$ 4.06

At December 31, 2004, 1,952,641 options were available for grant under the Plan.

	Options Outstanding			Exercisable	
Range of 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	1,004,672	$ 1.18	6.08	901,567	$ 1.13
$2.20 to $ 3.30	2,568,036	2.99	8.14	617,374	2.91
$3.30 to $ 5.50	2,400,305	4.04	8.89	278,218	4.16
$5.50 to $ 6.60	2,111,026	5.78	8.27	1,244,219	5.77
$6.60 to $11.00	503,825	8.75	8.09	226,525	9.28
	8,587,864			3,267,903	

The weighted average grant date fair value per share of shares under option was $1.99, $1.72 and $2.47 for the years ended December 31, 2004, 2003 and 2002, respectively.

No compensation expense was recorded as a result of stock options granted to employees in the years ended December 31, 2004, 2003 and 2002 as the fair market value approximated the per share exercise price of the respective options granted. With respect to options granted to employees in 1999, there were 446,459 shares under options granted in January 1999 with an estimated fair market value of $1.58 per share, 65,910 granted in April 1999 and 6,591 granted in May 1999 with an estimated fair market value of $2.37 per share, all of which were granted at an exercise price of $1.18 per share. The difference between the exercise price and the fair market value at the date of grant of $262,000 was accounted for as unearned compensation and was amortized to expense over the related service period. The Company recorded a total of approximately $0, $0 and $63,000 as compensation expense for the years ended December 31, 2004, 2003 and 2002, respectively, related to options granted to employees.

NOTE 11. RELATED PARTY TRANSACTIONS:

The Company occupies two leased facilities of approximately 24,500 and 48,600 square feet in Santa Ana, California, in which its executive offices, manufacturing, engineering, research and development and testing operations are located. 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 is $17,000 until August 1, 2005, at which time the monthly base rent will be adjusted based by an independent appraiser. Beginning on August 1, 2007, the monthly base rent will 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 is $33,000 until August 1, 2005, at which time the monthly base rent will be adjusted based by an independent appraiser. Beginning on August 1, 2007, the monthly base rent will be adjusted every two years based on the change in the Consumer Price Index

Building rent expense for these two facilities amounted to $603,000 for each of the years ended December 31, 2004, 2003 and 2002. At December 31, 2004, 2003 and 2002, there was no outstanding facility rent owed to MDC.

In 2004 and 2003, the Company purchased $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.

NOTE 12. 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.

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.

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

	Year Ended December 31, 2004		
	OEM	Consumer	Consolidated
Net revenues	$131,696,000	$143,736,000	$275,432,000
Cost of revenues	106,133,000	122,136,000	228,269,000
Gross profit	$ 25,563,000	$ 21,600,000	$ 47,163,000

	Year Ended December 31, 2003		
	OEM	Consumer	Consolidated
Net revenues	$ 58,424,000	$153,382,000	$211,806,000
Cost of revenues	45,579,000	130,348,000	175,927,000
Gross profit	$ 12,845,000	$ 23,034,000	$ 35,879,000

	Year Ended December 31, 2002		
	OEM	Consumer	Consolidated
Net revenues	$ 41,536,000	$134,995,000	$176,531,000
Cost of revenues	29,016,000	114,566,000	143,582,000
Gross profit	$ 12,520,000	$ 20,429,000	$ 32,949,000

For the years ended December 31, 2004, 2003 and 2002, international sales comprised 18%, 19% and 15% 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.

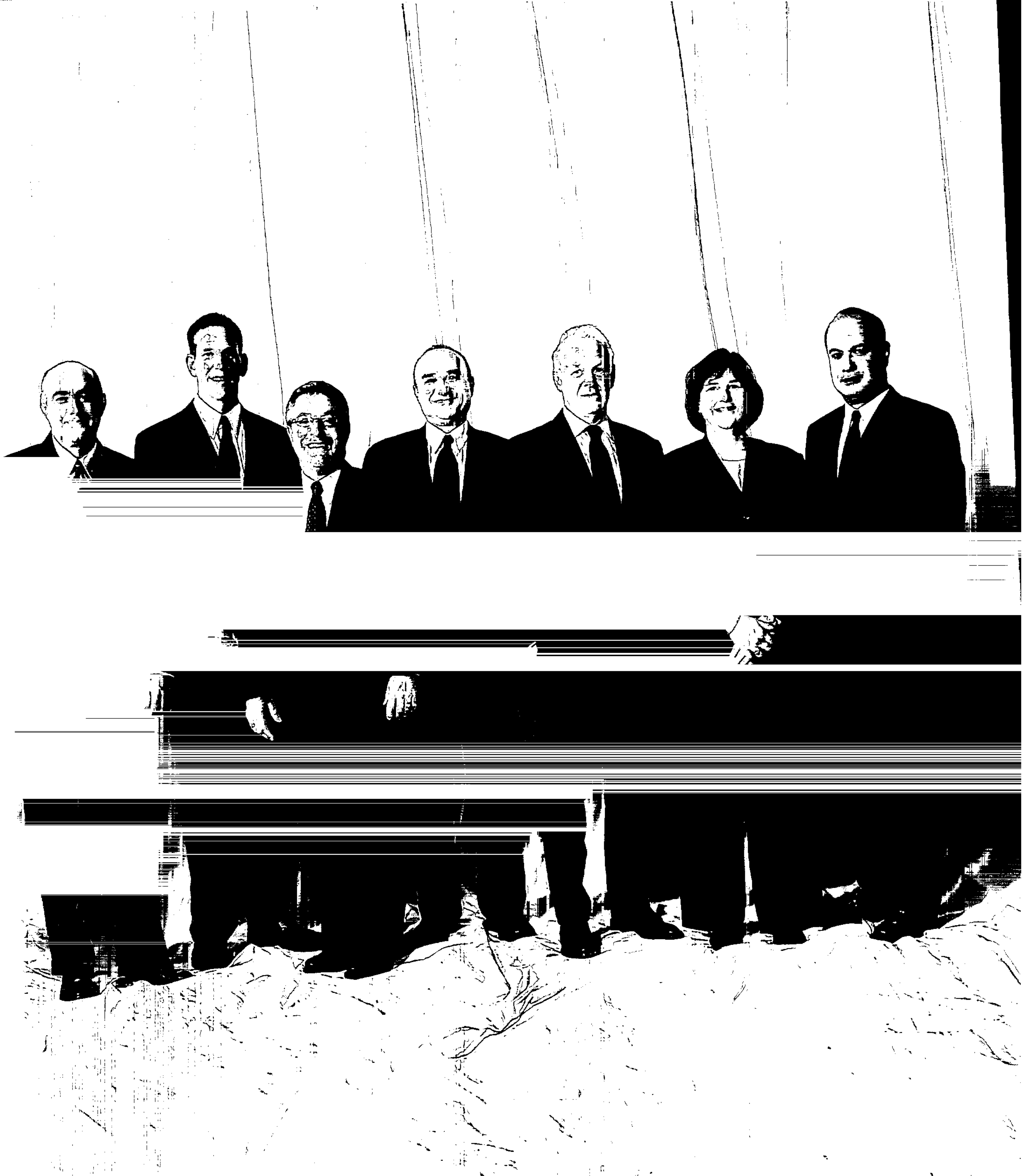
NOTE 13. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED):

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

Quarter Ended:	December 31, 2003	September 30, 2003	June 30, 2003	March 31, 2003
Net revenues	$ 68,673	$ 57,470	$ 44,745	$ 40,918
Gross profit	11,268	9,815	7,724	7,072
Operating income	2,491	2,500	574	(995)
Income from continuing operations	1,699	1,705	517	(439)
Loss from discontinued operations	(1,445)	(1,307)	(1,257)	(1,121)
Net income (loss)	$ 254	$ 398	$ (740)	$ (1,560)
Net income per share:				
Basic:				
Continuing operations	$ 0.04	$ 0.04	$ 0.01	$ (0.01)
Discontinued operations	$ (0.03)	$ (0.03)	$ (0.03)	$ (0.03)
Total	$ 0.01	$ 0.01	$ (0.02)	$ (0.04)
Diluted:				
Continuing operations	$ 0.04	$ 0.04	$ 0.01	$ (0.01)
Discontinued operations	$ (0.03)	$ (0.03)	$ (0.03)	$ (0.03)
Total	$ 0.01	$ 0.01	$ (0.02)	$ (0.04)

Our Management Team

If what the late President Ronald Reagan said is correct – *Surround yourself with the best people you can find, delegate authority, and don't interfere as long as the policy you've decided upon is being carried out* – then we believe that SimpleTech is in great shape for the future.



left to right: Luis Morales, VP Corporate Development / Tim Wright, VP Channel Sales / Vahid Ordoubadian, General Manager, Storage Products / Pat Wilkison, VP Marketing and Business Development / Lorenzo Salhi, Senior Director, OEM Sales / Mike Moshayedi, President / Manouch Moshayedi, Chairman and CEO / Mark Moshayedi, COO, CTO and Secretary / Nader Salessi, VP Engineering / Dan Moses, CFO / Mitch Gellman, Director of Investor Relations / Mehrdad Komeili, CIO / Steve McCarthy, Director OEM Programs / Jami Wetmore, VP Corporate Controller / Shane Mortazavi, VP Operations / not shown: Bill Gervasi, VP DRAM Technology / Jeff Jones, VP Consumer Sales / Eric Neseth, VP International Sales / Mike Nilsson, VP OEM Sales [illegible] A copy of the company's annual report on form 10-K for the year ended December 31, 2004, and other interim [illegible] reports may be obtained, without charge, by contacting SimpleTech investor relations in writing at 3001 Daimler Street, Santa Ana, CA 92705 or by telephone at (949) 260-8328 or viewing these reports online at www.simpletech.com or www.sec.gov.

[illegible] Registered Public Accounting Firm
[illegible]waterhouseCoopers LLP
[illegible], CA

[illegible] Share Prices The following table sets forth the closing sales prices per share of our common stock on The Nasdaq National Market on December 31, 2004 and March 1, 2005. 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
[illegible]ember 31, 2004	$ [illegible]
[illegible] 13, 2005	$ [illegible]

[illegible] Information Our common stock has traded on The Nasdaq National Market under the symbol "STEC." Our initial public offering of stock occurred on September 29, 2000. Prior to that time, there was no public market for our common stock. 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.

[illegible] Range of Common Stock

[illegible] Ended December 31, 2004:	High	Low
[illegible] Quarter	$ 6.99	$ 4.22
Second Quarter	$ 5.96	$ 3.22
[illegible] Quarter	$ [illegible]	$ 2.76
[illegible] Quarter	$ [illegible]	$ 3.66
[illegible] Ended December 31, 2003:		
[illegible] Quarter	$ [illegible]	$ 1.97
Second Quarter	$ [illegible]	$ 2.20
[illegible] Quarter	$ [illegible]	$ 3.50
[illegible] Quarter	$ [illegible]	$ 4.87

[illegible] As of April 13, 2005, there were 55 holders of record of our common stock.

[illegible] 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 [illegible] 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 [illegible] factors the board deems relevant.

Corporate Directory

Board of Directors

F. Michael Ball (1)
Executive Vice President and President,
Pharmaceuticals, Allergan, Inc.

Mark R. Hollinger (1)
President and Chief Executive Officer,
Merix Corporation

James J. Peterson (1)
President & Chief Executive Officer,
Microsemi Corporation

Dan Moses (2)
Chief Financial Officer,
SimpleTech, Inc.

Manouch Moshayedi (2)
Chairman and Chief Executive Officer,
SimpleTech, Inc.

Mark Moshayedi
Chief Operating Officer,
Chief Technical Officer and Secretary,
SimpleTech, Inc.

Mike Moshayedi
President,
SimpleTech, Inc.

(1) Member of the Audit, Compensation
and Nominating and Corporate
Governance Committees
(2) Member of the Special Stock Option
and Special Banking and Investment
Committees

Corporate Officers

Manouch Moshayedi
Chairman and Chief Executive Officer

Mark Moshayedi
Chief Operating Officer,
Chief Technical Officer and Secretary

Mike Moshayedi
President

Dan Moses
Chief Financial Officer

Corporate Office

SimpleTech, Inc.
3001 Daimler Street
Santa Ana, California 92705
phone 1 949 476 1180
www.simpletech.com

Investor Relations
Mitch Gellman
Director of Investor Relations
Direct 949 260 8328
cell 949 232 5080
fax 949 417 0609
ir@simpletech.com

Annual Meeting
Thursday, May 26, 2005
8:00 am Pacific Standard Time
Irvine Marriott Hotel
18000 Von Karman
Irvine, California 92612

Stock Transfer Agent
American Stock Transfer &
Trust Company
New York, NY

Legal Counsel
Sonnenschein Nath & Rosenthal LLP
Los Angeles, CA

NASDAQ AeA